IN THE TENNESSEE COURT OF APPEALS
MIDDLE SECTION AT NASHVILLE

SENTINEL TRUST COMPANY, Danny N. Bates, Clifton T. Bates, Howard H. Cochran, and Gary L. O'Brien, Petitioners-Appellants, v. KEVIN P. LAVENDER, Commissioner Tennessee Department of Financial Institutions, Respondent-Appellee.	)	No. M2005-01073-COA-R3-CV

BRIEF OF APPELLEE COMMISSIONER KEVIN P. LAVENDER, TENNESSEE DEPARTMENT OF FINANCIAL INSTITUTIONS

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INTRODUCTION

This case presents an appeal as of right by Appellants, Danny Bates, Clifton T. Bates, Howard H. Cochran, and Gary L. O'Brien, of a final order issued by the Davidson County Circuit Court (sitting by interchange for the Davidson County Chancery Court) dismissing their petition for writs of supersedeas and common-law certiorari. Appellants had filed their petition seeking judicial review of the Commissioner of Financial Institution's decision to take possession of Sentinel Trust Company and to subsequently liquidate the company.

This brief is submitted on behalf of the Appellee Commissioner Kevin P. Lavender. The record in this case contains eight (8) volumes of the technical record, which shall be referred to as "TR"; seven (7) volumes of transcript of proceeding before the Davidson County Circuit Court, which shall be referred to as "TE"; three (3) sealed volumes of the Administrative Record, which shall be referred to as "AR"; and three (3) volume of exhibits (Exhibits 1-34), which shall be referred to as "Exh.".

STATEMENT OF THE ISSUES

1. Whether this case is moot as there is no effectual relief that can be granted? (Appellants' Issue No. 4).

2. Whether the Commissioner exceed his jurisdiction or acted illegally in taking possession of Sentinel Trust Company? (Appellants' Issue No. 1).

3. Whether there is substantial and/or material evidence in the record to support the Commissioner's decision to take possession of Sentinel Trust Company and subsequent decision to liquidate the company? (Appellants' Issue No. 2).

4. Whether Tenn. Code Ann. § 45-2-1502 authorizing the Commissioner to take possession of Sentinel Trust Company is unconstitutional? (Appellants' Issues No. 3 and 5).

STATEMENT OF THE CASE

This case began on May 18, 2004, when Appellee Kevin P. Lavender, Commissioner of the Tennessee Department of Financial Institutions ("Commissioner"), took emergency possession of Sentinel Trust Company ("Sentinel"), a state-chartered trust company, and filed such Notice of Possession with the Lewis County Chancery Court, pursuant to Tenn. Code Ann. §§ 45-2-1502(b)(1) and (c)(1).[1] The Notice stated that the Commissioner had found: (1) that Sentinel had used pooled fiduciary funds, that were to be held in trust for certain bond issues, to provide operating capital for non-related defaulted bond issues, thereby creating a fiduciary cash shortfall that greatly exceeded Sentinel's current operating capital and, (2) that Sentinel had failed to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion and had otherwise failed to keep accurate books and records.[2] The Commissioner further found that Sentinel's potential liability for the cash shortfall in the pooled fiduciary account exceeded its current capital level and that Sentinel has been unable to provide a viable capital plan that would eliminate the deficiency and make the account whole.[3] Accordingly, the Commissioner found that the following grounds for possession, as set forth in Tenn. Code Ann. § 45-2-1502(a), existed: (1) Sentinel's business was being conducted in an unsound manner and (2) Sentinel was unable to continue normal operations.[4] Additionally, as required by Tenn. Code Ann. § 45-2-1502(c)(1), the Notice of Possession provided that "[a]ny person aggrieved or directly affected by

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[1] TR, Vol. 1, 56-57.

[2] *Id.*

[3] *Id.*

[4] *Id.*

the Commissioner's emergency possession of Sentinel Trust Company may have judicial review in Davidson County Chancery Court by common-law writ of certiorari, as provided in Title 27, Chapter 9, of Tennessee Code Annotated."[5]

That same day, the Commissioner also issued an order appointing Receivership Management, Inc. to act as the Receiver of Sentinel ("Receiver"), pursuant to Tenn. Code Ann. § 45-2-1502(b)(2).[6] Upon taking possession, the Receiver and Department personnel immediately began reviewing and analyzing Sentinel's books and records in an attempt to determine the true financial status of the company, including the extent of the shortfall in the pooled fiduciary account, as of the date of possession (May 18, 2004).[7] On June 15, 2004, the Receiver and Department personnel issued a preliminary report ("the Report") on the fiduciary and corporate financial positions of Sentinel, based upon a review of Sentinel's own records.[8] Those records reflected, as set forth in the Report, that Sentinel had a cash deficiency or shortfall in the pooled fiduciary account[9] that ranged from $7,612,218.00 to $8,430,722.00.[10] In addition, the Receiver and Department personnel had discovered bond principal and interest checks in Sentinel's vault, written on the pooled fiduciary account, totaling $559,873, thus potentially increasing the cash

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[5] *Id.*

[6] TR. Vol. 1, 59-73.

[7] TR. Vol. IV, 409; AR, Vol. III, 603.

[8] *Id.*; AR, Vol. III, 623-641.

[9] The pooled fiduciary account is a Sentinel account held at SunTrust Bank, in which funds were deposited, in trust, by bond issue borrowers and/or issuers for payment of principal and interest and other matters associated with the particular bond issue. The funds in that account were co-mingled by Appellants and were withdraw by them for purposes other than for what the funds were deposited.

[10] *Id.* at 92-93.

deficiency in the pooled fiduciary account by this amount.[11] The Report also reflected that, as of May 18, 2004, Sentinel had total corporate assets of $1,389,682. Taking into account the cash deficiency in the pooled fiduciary account (which is reflected as an accounts payable), the Report determined that Sentinel was insolvent in an amount of at least $6,225,445 as of May 18, 2004.[12]

Based upon the findings contained in the Report and the record as a whole, the Commissioner determined that liquidation of Sentinel in accordance with the provisions of Tenn. Code Ann. §§ 45-2-1502(c)(2) and 1504 was necessary and appropriate. Accordingly, on June 18, 2004, the Commissioner issued a Notice of Liquidation of Sentinel Trust Company.[13] As with the Notice of Possession, the Notice of Liquidation specifically provided that "[a]ny person aggrieved or directly affected by the Commissioner's determination to liquidate Sentinel Trust Company may have judicial review in Davidson County Chancery Court by common law writ of certiorari, as provided in Title 27, Chapter 9 of Tennessee Code Annotated, pursuant to Tenn. Code Ann. § 45-1-108(a)."[14]

On June 29, 2004, Appellants, who are the former officers and directors of Sentinel Trust Company, filed a petition in Davidson County Chancery Court for a writ of supersedeas and common law writ of certiorari, seeking supervisory judicial review of the Commissioner's decisions to take possession of and to liquidate Sentinel Trust Company .[15] The Petition rested

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[11] *Id.* at 85.

[12] *Id.* at 94. This insolvency does not include the $559,873 in bond principal and interest checks discussed, *supra*, which increases the fiduciary cash deficiency, and would increase the insolvency by a corresponding amount.

[13] TR., Vol. IV, 77; AR, Vol. III, 644-646.

[14] *Id.* at 71-72.

[15] TR, Vol. I, 1-22.

primarily upon the assertion that since "no statute provides that the term "bank" includes "trust company" with reference to any other provisions of the Tennessee Banking Act", the Commissioner had no authority to exercise any of his "bank regulatory powers" against Sentinel, a non-banking trust company, including Tenn. Code Ann. § 45-2-1502, which authorizes the Commissioner to take possession of a state bank in certain circumstances.[16] Instead, Petitioners asserted that the Commissioner only has

> the general power to enforce applicable laws against trust companies, including both statutes applicable by their terms only to trust companies (*supra*, ¶ 7), and statutes in the Tennessee Banking Act concerning fiduciary functions which, by their explicit terms, are applicable both to trust companies and to banks authorized to exercise fiduciary powers, T.C.A. §§ 45-2-1002-1006.[17]

The writ of certiorari was subsequently issued on July 1, 2004.[18]

On July 16, 2004, Appellants filed a motion requesting an expedited hearing on the petition for *writ of supersedeas only*.[19] On July 26, 2004, the Commissioner filed a response stating that he had no objection to an expedited hearing on the petition for writ of supersedeas, and further, requested that the Court hold immediate hearings on both the petition for writ of supersedeas and for writ of certiorari.[20] The following day, July 27, 2004, the Commissioner filed under seal the Administrative Record before the Commissioner, pursuant to Tenn. Code

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[16] *Id.* at ¶ 9.

[17] *Id.*

[18] TR, Vol. I1, 172-173.

[19] TR, Vol. 1I, 190-196.

[20] TR, Vol, III, 389-90.

Ann. § 27-9-109.[21] The Commissioner also filed his response in opposition to both the petition for writ of certiorari and writ of supersedeas.[22] In his response, the Commissioner asserted that he had acted with express statutory authority in taking possession and in determining to liquidate Sentinel Trust Company, pursuant to Public Chapter 112, Acts of 1999, codified at Tenn. Code Ann. § 45-1-124. The Commissioner further asserted that the statutes authorizing him to take possession were constitutional. Finally, the Commissioner asserted that there was substantial and material evidence in the record to support both his decision to take possession and to liquidate Sentinel.[23]

Before a hearing could be held on their petition for writ of supersedeas, Appellants filed a supplemental petition for writ of mandamus on July 30, 2004.[24] This petition sought an order of mandamus from the Davidson County Chancery Court directing the Commissioner to terminate the ongoing liquidation of Sentinel Trust Company under the jurisdiction of the Lewis County Chancery Court.[25]

On August 4, 2004, the Commissioner filed a supplemental response to the petition for writ of supersedeas, which specifically addressed the factors the court should consider in granting a writ of supersedeas.[26] The supplemental response also included a transcript of the legislative

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[21]TR, Vol. III, 391-92.

[22]TR, Vol. IV, 393-448.

[23]*Id.*

[24]TR, Vol. V, 585-591.

[25]*Id.*

[26]TR, Vol. V, 635-649.

debates on Public Chapter 112, which clearly demonstrated the Legislature's understanding and intent that all the provisions of the Tennessee Banking Act (chapters 1 and 2 of Title 45) would apply to state trust companies.[27]

A hearing on the petition for writ of supersedeas was held on August 5, 2004.[28] Prior to that hearing, the trial court offered to consolidate the hearing on the request for supersedeas with review by common-law writ of certiorari and schedule such hearing within 7-10 days so that all issues before the Court could be timely resolved.[29] The Commissioner was in agreement that a single hearing on all the issues was appropriate and was willing to stay the ongoing liquidation of Sentinel until such hearing. However, Appellants were not willing to agree to a consolidated hearing, but instead, sought to proceed solely on the request for supersedeas, based upon the legal argument that the Commissioner was acting without statutory authority.[30]

On August 9, 2004, the court issued a memorandum and order denying the Petition for Writ of Supersedeas.[31] In doing so, the court first noted that "the lawyer for the petitioners has chosen the battleground. He has chosen to not yet enter the factual fray but has chosen the law as his weapon."[32] The court then went on to find that the "Tennessee banking laws contained in Chapters 1 and 2 of Title 45 fully apply to trust companies and that these statutes are

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[27]TR, Vol. VI, 656-658..

[28]TR, Vol. V, 633-34. On August 9, 2004, an order was entered transferring the case from Part I, Davidson County Chancery Court to Judge Kurtz, Fifth Circuit, Davidson County Circuit Court. TR, Vol. VI, 681.

[29]TR, Vol., VI, 684.

[30]*Id.*

[31]TR, Vol. VI, 682-694.

[32]*Id.* at 688.

constitutional."[33] As such, the Court found that the Commissioner had acted with express statutory authority in taking possession and determining to liquidate Sentinel Trust Company.[34] The Court did not, however, make an opinion as to the factual foundation supporting the decisions to take possession and liquidate, as such issues had not been presented to the Court.[35]

On August 13, 2004, Appellants filed a motion with the trial court requesting that the court: (1) vacate or revise its August 9th order; (2) enter final judgment for Appellants upon both the writs of certiorari and supersedeas on the basis of the pleadings; (3) reserve to Appellants the right to an evidentiary hearing; and, (4) grant an immediate interlocutory appeal in the event this Court declines to vacate or revise its previous order.[36] Appellants also requested an expedited hearing on this motion. On August 17, 2004, the trial court issued an order directing the Commissioner to file a response to the motion within seventy-two (72) hours.[37] This response was filed by the Commissioner on August 20, 2004.[38]

On August 24, 2004, the trial court issued an Order denying the motion, adhering to its decision and reasoning set forth in its August 9 Memorandum and Order.[39] The court did, however, grant Appellants permission to seek an interlocutory appeal pursuant to Rule 9 of the

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[33] *Id.* at 693.

[34] *Id.* at 691.

[35] *Id.* at 693.

[36] TR, Vol. VI, 701-705.

[37] TR, Vol. VI, 711-712.

[38] TR, Vol. VI, 715-727.

[39] TR, Vol. VII, 819-821.

Tennessee Rules of Appellate Procedure.[40] On August 27, 2004, Appellants filed an Interlocutory Application for Permission to Appeal and Application for Extraordinary Appeal pursuant to Tenn.R.App.P. 9 and 10.[41] On September 1, 2004, this Court issued an order dismissing both appeals.[42] In that Order, this Court stated as follows:

> Having reviewed the application and supporting documents, we cannot conclude that an interlocutory appeal is necessary to prevent irreparable harm or to prevent needless, expensive and protracted litigation. Nor can we conclude that the trial court has so far departed from the acceptable and usual course of judicial proceedings as to require immediate review under Tenn.R.App.P. 10.[43]

No further action took place in this case until March 4, 2005, when Appellants filed a motion with the trial court requesting that the case be transferred to the Lewis County Chancery Court for hearing, or in the alternative to set a scheduling conference so that a trial date could be set.[44] The Commissioner filed a response on March 15, 2005, in which he objected to the transfer of this case to Lewis County Chancery Court, but reiterated his willingness to have an expedited hearing on the petition for writ of certiorari.[45]

After a status conference, the court issued an order setting a final hearing for March 29, 2005.[46] The court further noted that its scope of review was governed by T.C.A. § 27-9-111 and

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[40] *Id.*

[41] *See Sentinel Trust Company, et al. v. Kevin P. Lavender*, App. No. M2004-02068-COA-R10-CV.

[42] TR, Vol. VII, 823.

[43] *Id.*

[44] TR, Vol. VII, 842-844.

[45] TR, Vol. VII, 845-856.

[46] TR, Vol. VII, 865-867.

was restricted to the record below, but that additional evidence could be introduced on the question of whether the Commissioner exceeded his jurisdiction or acted illegally, arbitrarily, or capriciously.[47] Further, because this was a post-seizure hearing, the court held that it would be liberal in allowing the introduction of evidence in order to insure that the hearing fully complied with the concepts of due process, even though Appellants had waited approximately eight (8) months post-seizure to ask for a hearing challenging the Commissioner's factual determinations.[48]

After a two-day evidentiary hearing, the court issued a memorandum and order on April 13, 2005, denying the petition for writ of certiorari and dismissing the case.[49] In doing so, the court first noted that any failure to have a prompt post-seizure hearing challenging the factual basis for the Commissioner's seizure was entirely the fault of the Appellants.[50] The court then found that because the factual challenge had been delayed so long by Appellants, the case was now moot, as the receivership and liquidation had been proceeding for eleven (11) months and Sentinel was nothing but an empty shell.[51]

The court went on to find that if it were to reach the factual merits, it would affirm the actions of the Commissioner. Specifically, the court found that "the facts support the conclusion of the Commissioner that an emergency existed and that the money in the pooled trust account

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[47] *Id.*

[48] *Id.*

[49] TR, Vol. VII, 921-952.

[50] *Id.* at 947.

[51] *Id.* at 948.

belong to the bond holders was in immediate threat if he did not act" and that the record further supported the Commissioner's decision to liquidate.[52] Appellants timely filed a notice of appeal on April 19, 2005.[53]

[52] *Id.* at 952.

[53] TR, Vol. III, 954-55.

STATEMENT OF FACTS

Appellants Danny N. Bates, Clifton T. Bates, Howard H. Cochran, and Gary L. O'Brien are all either former directors, officers and/or shareholders of Sentinel Trust Company, a state-chartered trust company located in Hohenwald, Lewis County, Tennessee.[54] Appellee, Kevin P. Lavender, is the duly appointed Commissioner of the Tennessee Department of Financial Institutions, and is charged with enforcing and administering the provisions of chapters 1 and 2 of Title 45 of the Tennessee Code Annotated.[55]

1. Administrative Record

On April 28, 1999, the Tennessee General Assembly enacted Public Chapter 112, with an effective date of July 1, 1999. This act, as discussed further herein, made the operation and regulation of all state trust companies subject to the Tennessee Banking Act, codified in Chapters 1 and 2 of Title 45. In anticipation of the July 1 effective date, on June 16, 1999, the Department of Financial Institutions sent a memorandum to all known trust companies not previously under the Department's regulation, including Sentinel Trust Company ("Sentinel").[56] The

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[54]Appellants have filed their case in the name of Sentinel Trust Company and in their individual names. The Commissioner objected and continues to object to any such case being brought in the name of or on behalf of Sentinel. Tenn. Code Ann. § 45-2-1502(b)(2) provides that once the Commissioner has taken possession, "the ***commissioner shall be vested with the full and exclusive power of management and control***, including the power to continue or to discontinue the business, to stop or to limit the payment of its obligations, to employ any necessary assistants, to execute any instrument in the name of the bank, ***to commence, defend and conduct in its name any action or proceeding in which it may be a party*** . . .. (Emphasis added). Unless and until the Commissioner is ordered to return possession of Sentinel to Appellants, he is vested with the "full and exclusive power of management and control" of Sentinel, including the commencing of any legal action in the name of Sentinel. *See also, First Savings & Loan Association v. First Federal Savings & Loan Association*, 531 F.Supp. 251, 255 (D. Hawaii 1981)("When a receiver is appointed for a corporation, the corporation's management loses the power to run its affairs and the receiver obtains all of the corporation's powers and assets.").

[55]Tenn. Code Ann. § 45-1-104.

[56]AR. Vol. I, 206.

memorandum informed these trust companies that with the enactment of Public Chapter 112, they were now subject to the jurisdiction of the Department.

Subsequently, on December 31, 1999, the Department commenced a formal examination of Sentinel pursuant to Tenn. Code Ann. §§ 45-1-124(h) and 45-2-1602.[57] During the course of that examination, the Department determined that Sentinel had no written policies for any aspect of their Trust Administration Department. The Department further discovered that Appellant Danny Bates, President and sole shareholder of Sentinel, had virtually unrestricted access to all areas of the company with little if any compensating controls, and that he was responsible for all trust company activities, including managing and monitoring existing accounts, compilation of the general ledger, asset management and account reconciliation.[58] The Department's examination report noted a number of deficiencies and/or violations and gave Sentinel a composite rating of "3".[59] The report further noted that since Sentinel was a "grandfathered" trust company, it had until three years after July 1, 1999, to come into compliance with the noted deficiencies/violations.[60]

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[57]AR. Vol. I, 9-41.

[58]AR. Vol. I, 20, 23-24.

[59]All trust companies and bank trust departments in Tennessee are evaluated under the standards provided by the Uniform Interagency Trust Rating System. This system was initially adopted September 21, 1978 by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System, and in 1988 by the Office of Thrift Supervision. On October 5, 1998, the Federal Financial Institutions Examination Council ("FFIEC") approved and adopted revisions to the system. Under the current system, a trust company or department is evaluated in five component areas: management; operations, internal controls and audits; earnings; compliance; and asset management. The trust company is rated "1" to "5" (with "1" being best and "5" being worst) in these component areas in accordance with stated guidelines. The trust company is then given a composite rating of "1" to "5" (again, with "1" being best and "5" being worst).

[60]AR. Vol. I, 17.

On November 2, 2000, the Department was made aware of a judgment in the amount of $2,226,047 that had been entered against Sentinel by the Davidson County Chancery Court on March 17, 2000 (*National Commerce Financial Bancorporation ("NCFB") v. Sentinel Trust Company*, Docket No. 97-2243-I).[61] The lawsuit alleged that Sentinel had breached its contractual fiduciary obligations as trustee under trust indentures securing certain private placement notes. President Bates had failed to disclose this judgment during the course of management's exit interview with the Department on May 31, 2000.[62] This judgment, if made final, would be well in excess of Sentinel's capital and would deem the company insolvent. Accordingly, on November 16, 2000, then Commissioner Bill Houston downgraded the company's December 31, 1999 examination Composite rating from a "3" to a "5".[63] Commissioner Houston also served a Cease and Desist Order upon Sentinel, which the Board agreed to the entry thereof.[64] Sentinel later settled the judgment for $575,000, which prevented the company from being declared insolvent.[65]

On January 26, 2001, the Department began an examination of Sentinel for the year ending December 31, 2000. The examination report found that President Bates continued to have virtually unrestricted access to all areas of the company with limited compensating controls established. The report found that there was no documentation of management's reconciliation

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[61]AR. Vol. I, 58-59, 65, 189.

[62]AR. Vol. I, 58, 189.

[63]AR. Vol. I. 59, 65.

[64]*Id.*

[65]*Id.*

and review procedures and that President Bates was reconciling deposit accounts with no documented review by another party.[66] The report further noted that there were inconsistencies in the accuracy of the corporate and trust records and that there was no internal audit function in place.[67] Specifically, the report stated that "[r]econciling trust and corporate general records was difficult" and that "[t]he accuracy of reports appears suspect due to inconsistencies in totals, as well as, the varying formats and data processing systems used."[68] Finally, the report noted that guidelines and policies in regards to operations, internal controls, reconcilement of deposits and securities, balancing of accounts, information technology, audit function, investment management and contingency plan were all needed to provide supervision of Sentinel's corporate trust activities.[69]

Once again, Department examiners noted in the report that Sentinel was a "grandfathered trust" and, therefore, had until July 1, 2002 to come into compliance with the deficiencies/violations noted in the report (many of which had been noted in the previous report).[70] The Department once again only gave Sentinel a composite rating of "3" on this examination report.[71]

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[66]AR. Vol. 1, 62.

[67]AR. Vol. 1, 63.

[68]AR. Vol. 1, 71.

[69]AR. Vol. I, 63, 71.

[70]AR. Vol. 1, 63.

[71]AR. Vol. 1, 64.

Additionally, because of a continued concern over the unreliability of Sentinel's corporate and fiduciary records, as well as management's inability or refusal to provide information documenting and supporting various entries on the Company's balance sheet, coupled with the type of fiduciary business the company administered, the report recommended that Sentinel be required to submit 90 day Progress Reports to the Department.[72]

On April 9, 2001, the Department received an application from Sentinel to amend its charter to change the principal office address to 29 West Main Street, Hohenwald, Tennessee; to delete the phrase "*but said corporation is not to carry on the business of banking*" and, to state the authorized amount of shares to be 5,000,000.[73] The Department subsequently issued and recorded an amended and restated charter for Sentinel reflecting the above-requested changes.[74]

On April 22, 2002, the Department began its third annual examination of Sentinel for the year ending December 31, 2001. The report noted that the Board of Directors had adopted the Federal Deposit Insurance Corporation's Statement of Principle of Trust Department Management on September 21, 2000 as part of its Policy Manual.[75] The report further found, however, that President Bates was still primarily responsible for trust operations and continued to perform the majority of the corporate operation tasks himself.[76] The report also noted that Sentinel continued to operate without a formal internal audit program and that President Bates

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[72]AR. Vol. I, 107-108.

[73]AR. Vol. I, 191.

[74]AR. Vol. I, 192.

[75]AR. Vol. I, 6-8, 129.

[76]AR. Vol. I, 131

continued to record and reconcile all depository accounts and do most of the corporate and fiduciary bookkeeping without any internal review.[77]

Additionally, the report raised the issue of the overdrafts in the accounts of the defaulted bond issues and noted that it was not clear as to how these overdrafts were funded, but that it appeared funds from other bond issues were being used. The report specifically reminded Sentinel's management of its duty "to keep trust account assets separate" and that the "funds of one bond issue are not be used for another bond issue, nor are funds within the various bond issues to be used for anything other than their stated purpose."[78]

In addition, during the course of the examination, President Bates admitted that he had left $800,000 in assets off the Company's balance sheet when he had submitted the company's December 31, 2000 and December 31, 2001 Call Reports to the Commissioner. President Bates further admitted that this was done intentionally in an attempt to make Sentinel look less fiscally solvent than it actually was so as to obtain a lower settlement with NCFB.[79] As a result of this admission by President Bates and the submission by management of incorrect reports to the Commissioner, a Suspicious Activity Report was submitted in conjunction with the report.[80]

The April, 2002 examination report, which also covered the July 2002, October 2002 and January 2003 progress reports, was sent to Sentinel on February, 2003. In the cover letter, Commissioner Lavender specifically requested that management "provide information as to how

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[77]AR. Vol. I, 132, 162.

[78]AR. Vol. I, 134-35.

[79]AR. Vol. II, 229-234.

[80] AR. Vol. I, 162.

overdrafts are currently being funded for the various bond issues."[81] In response, President Bates sent a letter dated April 16, 2003 to the Commissioner, explaining funding of the overdrafts as follows:

> Fees and expenses are charged to the appropriate principal or income cash account of trust accounts as and when the fees and expenses are incurred. As a result, a cash overdraft will occur if payment is charged to an account holding little or no actual cash assets. In virtually all cases, however, the account will have non-cash assets in the process of being converted to cash and/or may hold collectible cash apart from the trustee. . . . Each trust account is separately identified and accounted for on a stand-alone basis. Cash and investment securities are collectively held for the individual accounts. Non-fungible assets such as real property, receivables and other pledged collateral are counted as nominal assets until converted into cash and received into the account. ***Fees and expenses are funded from collective cash assets and charged to appropriate individual trusts.***
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> * * *
>
> When assets are converted to cash, the overdraft is liquidated. All trust accounts should hold assets in excess of any temporary cash overdraft. ***Sentinel recognizes that disbursements for a trust in excess of recoverable assets are to be recorded as a corporate expense. That has been and remains it corporate policy.***[82]

On June 13, 2003, the Department began an examination of Sentinel for the year ending December 31, 2002. On July 25, 2003, the Department was informed that Sentinel's audit firm, Charles Welch and Associates, had withdrawn and declined to complete Sentinel's December 31, 2002 audit, due to the inability to obtain from management evidence needed to evaluate the fair value of Sentinel's "corporate fiduciary receivables."[83] Subsequently, on July 30, 2003,

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[81] AR. Vol. I, 114.

[82] AR. Vol. II, 227-228 (emphasis added).

[83] AR. Vol I, 195; Vol. II, 250.

President Bates confirmed that he had hired an independent CPA, Jim Brewer, to reconcile Sentinel's cash accounts, including the pooled fiduciary account.[84]

In light of this information, on August 8, 2003, the Department sent a memo to President Bates and the CPA, requesting explanations over several accounting issues that it had uncovered as the examination was proceeding.[85] One of the issues concerned the question of why the cash balance did not reconcile to either the fiduciary or corporate balance sheet totals or to the bank account statements.[86]

President Bates responded in two memoranda dated August 12 and 25, 2003.[87] In attempting to explain the discrepancies between the cash balance and the balance sheet totals and account statements, President Bates specifically stated that the "cash balance figure reported on the Trust Department Balance Sheet does not exist as an account register in AccuTrust which can be examined independently of the actual trust accounts. . . . To compensate for the lack of account registers in AccuTrust, transactions are posted independently in Quickbooks. At each month-end account records of AccuTrust and Quickbooks are compared and proofed. ***I believe our accounts are reconciled and balanced.***"[88] Additionally, President Bates provided an Account Reconciliation Report as of 5-31-2003.

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[84]AR. Vol. I, 196.

[85]AR. Vol. II, 250-252.

[86]*Id.*

[87]AR. Vol. II, 253-255.

[88]AR. Vol. II, 255 (emphasis added).

On October 6, 2003, the Commissioner met with the Board of Sentinel to inquire as to how expenses were funded by Sentinel for defaulted bond issues and to inform them of the urgency of the need for a financial statement audit of the company in order for the Commissioner to determine the solvency of the company.[89] Thereafter, on October 10, 2003, President Bates advised the Commissioner that Kraft CPAs had been engaged to perform an audit for the year ending December 31, 2002.[90]

Subsequently on February 13, 2004, the Department had a discussion with Kraft CPA concerning their audit of Sentinel.[91] As a result of that discussion, the Department came to the tentative conclusion that Kraft would be opining that

> ***the company has contingent liabilities as it relates to their account receivables that are believed to be non-collectible and will therefore render the company insolvent.*** These receivables are believed to be losses in regard to expenses related to defaulted bond issues that the company has funded with monies from other non-related bond issues. Minimal losses have been reflected on corporate records despite President Bates stating that that is the policy and practice of the company. These receivable amounts have not been reported on company financials but instead are reflected on the Quickbooks fiduciary recordkeeping system. Examiners have routinely been given the AccuTrust fiduciary records for examination purposes which is also what is sent in for Call Report purposes. These contingent liabilities are estimated to be approximately $ 4 million to $ 4.8 million."[92]

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[89]AR. Vol. I, 198-199.

[90]AR. Vol. I., 199.

[91]AR. Vol. II, 300-304.

[92]*Id.* (Emphasis added).

On March 19, 2004, the Department was provided with a copy of the audit report issued by Kraft.[93] In that report, Kraft identified approximately $9.4 million in fiduciary account receivables, of which approximately $7.5 million resulted from expenditures Sentinel had made in connection with defaulted bond issues and related unreimbursed costs and expenses. However, Kraft stated in the report that the company's records had been inadequate for them to satisfy themselves as to the existence, amount or collectability of those receivables and, due to the materiality of this issue, Kraft declined to give an opinion as to the financial status of Sentinel as of December 31, 2002.[94] Kraft also noted in its letter to management that: (1) Trust Department and Company cash had been commingled in the same bank account; (2) the Company appeared to have paid company expenses from Trust Department accounts and reimbursed the Trust Department at a later date; and, (3) the Company had not been preparing an accurate reconciliation of the bank balance to the general ledger on a monthly basis, but was simply adjusting the general ledger balance to the bank's monthly balance which resulted in the company and the Trust Department significantly overstating cash as of December 31, 2002.[95]

After receiving this audit report, Department examiners returned to Sentinel on March 22, 2004, to review additional records and information.[96] Based upon the records provided at this visitation, the Department conducted a reconciliation of the balance of the fiduciary accounts as of December 31, 2003, as reflected in the AccuTrust System and the Quickbooks System, and the

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[93]AR. Vol. I, 169-178.

[94]*Id.*

[95]AR. Vol. I, 169-170.

[96]AR. Vol. I, 201.

balance in the pooled fiduciary account (the SunTrust Account) as reconciled by the independent CPA, as well as the overdrafts on the defaulted bond issues shown in AccuTrust.[97] This reconciliation reflected a net cash shortage in the pooled fiduciary account of $5,789,011.[98]

Thereafter, on April 1, 2004, the Department examiners met with President Bates and an auditor from Kraft.[99] Prior to that meeting, President Bates had been provided with the reconciliation done by the Department and the determination of a net cash shortage of $5,789,011. During the meeting, President Bates was specifically asked if the Department's analysis and resulting determination of an approximately $5.7 million shortfall was incorrect. President Bates did not deny the accuracy of either, but instead, admitted this figure was close to the correct amount of the shortfall.[100] Furthermore, in addition to admitting the accuracy of the amount of the shortfall, neither President Bates, nor any other officer, director or employee of Sentinel, made any mention of a substantial amount of outstanding fees owed to Sentinel that would be available to offset this cash shortage.[101]

Thereafter, on April 5, 2004, the Commissioner sent a letter to Sentinel requesting an opinion of counsel regarding Sentinel's practice of funding defaulted bond expenses with funds from other non-related bond issues.[102] This practice, as understood by the Commissioner, was

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[97]AR.Vol. I, 202; AR. Vol. III, 630.

[98]*Id.*

[99]*See* TR, Vol. IV, 451. *See also*, AR. Vol. I, 202-203.

[100]*See* TR, Vol. IV, 449-456.

[101]*Id.*

[102]AR. Vol. II, 306-308.

that Sentinel served as the indenture trustee for various high-yield, unregistered municipal and corporate bonds. In a number of instances, the debtor had failed to make the scheduled principal and/or interest payments and the bond had been declared in default per the terms of the indenture. Sentinel, in its role as indenture trustee, would then fund various expenses relative to these defaulted issues, such as insurance, security, legal and other professional fees, in an effort to protect the value of the underlying collateral. While the governing indenture and/or bondholder indemnification usually provided for the reimbursement of these expenses from the proceeds from the sale of the collateral, Sentinel did not have adequate corporate liquidity to fund these expenses, in the event that the defaulted issue did not already have sufficient funds on deposit with Sentinel. Thus, in order to fund these expenses, Sentinel would "borrow" from other non-related bond issues by writing checks and/or wires on its pooled demand deposit account at SunTrust Bank (hereinafter referred to as the "pooled fiduciary account"). This practice of "borrowing" from the pooled fiduciary account to fund the expenses of the defaulted issues resulted in the approximately $7.5 million in fiduciary account receivables that Kraft had been unable to substantiate as to their actual existence, amount or collectability.[103]

In response to the Commissioner's April 5 letter, Sentinel and its counsel requested a meeting with the Commissioner. On April 28, 2004, the Commissioner and members of his staff met with Sentinel's Executive Vice-President, Paul Williams, and Sentinel's attorneys, Alex Buchanan and David Lemke, with the firm of Waller, Lansden, Dortch & Davis, PLLC.[104] In that meeting, Sentinel's counsel indicated that Sentinel's practice of funding defaulted bond expenses

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[103] *Id.*

[104] AR. Vol. II, 310, 316, 323.

with funds from other non-related bond issues was "inappropriate" and that such expenses were typically funded with corporate assets.[105]

On April 30, 2004, the Commissioner and his staff met with the board of Sentinel and its legal counsel. At that meeting, President Danny Bates admitted that his most recent calculations showed that Sentinel had a deficit fiduciary cash position of approximately $7.25 million, but that this figure fluctuated daily.[106] Mr. Bates made no mention, however, of the existence of outstanding substantial fees owed to Sentinel that would be available to offset the now $7.25 million fiduciary cash deficiency.[107] After this meeting, the Board adopted a new Corporate Trust Policy that specifically addressed the issue of funding expenses of defaulted bond issues.[108] The policy provides, among other things, that in order to avoid the loss of collateral or senior secured position, "advances may be made up to the expected liquidation value," but that "[f]unds may not be advanced from any trust account if it is anticipated that the advance creates an overdraft in the affected account."[109]

As a result of President Bates' admissions, on May 3, 2004, the Commissioner issued an Emergency Cease and Desist Order and Notice of Charges against Sentinel, pursuant to Tenn. Code Ann. §§ 45-1-107(a)(4), (5) and (c).[110] The Order and Notice declared that the

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[105]AR. Vol. II, 316, 323.

[106]AR. Vol. I, 203; Vol. II, 317, 323.

[107]*See* TR, Vol. IV, 449-456.

[108]AR. Vol. II, 350-353.

[109]AR. Vol. II, 351.

[110]AR. Vol. II, 311-337.

Commissioner had determined that Sentinel was operating in an unsafe and unsound manner and ordered Sentinel, among other things, to make an initial infusion of capital in the amount of $2 million by the close of business on May 17, 2004, to partially replenish the fiduciary cash deficiency. The order further directed Sentinel to submit a capital plan outlining the Company's plans to completely replenish the fiduciary pooled account and to outline the steps to be taken to provide sufficient operating capital.[111]

On May 6, 2004, Sentinel's then legal counsel advised the Board of Sentinel of its recommendation that it was in the best interests of the company for the Board to ask President Bates to resign as an officer and director of the Company.[112] Legal counsel further advised the Board that if President Bates did not voluntarily resign, they would have to resign as counsel to the Company.[113] President Bates refused to resign and counsel subsequently resigned from its representation of Sentinel.

On May 17, 2004, the Commissioner and his staff met with Sentinel's new legal counsel, Mary Neil Price with the firm of Miller and Martin. At that meeting, Sentinel's counsel admitted that Sentinel had not provided the Commissioner with a capital plan[114] because they did not have a "good enough handle on the financial situation."[115] However, prior to this meeting, Sentinel's counsel had provided an outline of steps that Sentinel proposed to take that they believed would

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[111] *Id.*

[112] AR. Vol. II, 370.

[113] *Id.*

[114] Sentinel had submitted a Capital Adequacy Plan to the Department on May 3, 2004, but withdrew it that same day. *See* AR. Vol. I, 204; AR. Vol. II, 339-342.

[115] AR. Vol. III, 453-455.

"improve Sentinel's financial position and [to] maximize funds available to repay any deficits in any default trust accounts for which funds are not available from other sources."[116] These steps included: (1) certain actions to reduce Sentinel's operating expenses; (2) an attempt to accelerate collection of advanced expenses on the defaulted bond issues; and (3) the financing of real property owned by Sentinel.[117] Nowhere in this proposal was there any mention, though, of the existence of substantial fees (default and administrative) owed to Sentinel that would be available to "maximize funds available to repay any deficits in any default trust accounts."

In addition to failing to provide a capital plan, Counsel indicated that Sentinel's management was only willing to make a total capital infusion of $225,000 instead of the $2 million directed by the Commissioner.[118]

In light of Sentinel's failure to comply with the primary directives of the Order and Notice, and in light of the record as a whole, the Commissioner determined that the only appropriate action necessary to protect the bond issuers and bondholders was to take possession of Sentinel. Accordingly, on May 18, 2004, the Commissioner took emergency possession of Sentinel pursuant to Tenn. Code Ann. §§ 45-2-1502(b)(1) and (c)(1).[119] That same day, the Commissioner issued an order appointing Receivership Management, Inc., to act as the Receiver of Sentinel, pursuant to Tenn. Code Ann. § 45-2-1502(b)(2).[120]

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[116]AR. Vol. III, 446-451.

[117]*Id.*

[118]*Id.*

[119]AR. Vol. III, 464-465.

[120]AR. Vol. III, 466-476.

Upon taking possession, the Receiver and Department personnel immediately began reviewing and analyzing Sentinel's books and records in an attempt to determine the true financial status of the company, including the extent of the shortfall in the pooled fiduciary account, as of the date of possession (May 18, 2004). This determination was hampered by the fact that Sentinel was using two different accounting systems — Quick Books and AccuTrust fiduciary accounting system — and that entries in these two systems were not consistently reconciled with each other or with the bank statements from the pooled fiduciary account.[121]

On June 15, 2004, the Receiver and Department personnel issued a preliminary report ("the Report") on the fiduciary and corporate financial positions of Sentinel, based upon a review of Sentinel's own records.[122] Those records reflected, as set forth in the Report, that as of December 31, 2003, Sentinel had a cash deficiency or shortfall in the pooled fiduciary account of $5,789,011.00. That cash deficiency in the pooled fiduciary account increased over the next four months such that by May 18, 2004, the deficiency ranged from $7,612,218.00 in Quick Books to $8,430,722.00 in the AccuTrust fiduciary accounting system. In addition, the Receiver and Department personnel had discovered bond principal and interest checks in Sentinel's vault totaling $861,107.11.[123] Thus, Sentinel's cash deficiency in the pooled fiduciary account should actually be increased by the amount of these checks such that the cash deficiency ranges from between $7,913,451.11 to $8,731,956.11.

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[121]AR. Vol. III, 603.

[122]AR. Vol. III, 623-41.

[123]*Id.* Since the issuance of the report on June 15, 2004, the Receiver and Department staff have found additional principal and interest checks increasing the total amount to $861,107.11. By August 4, 2004, demands totaling $105,000 for bond principal checks had been received. *See also* TR, Vol. IV, 449-456.

The report also reflected, based upon Sentinel's own records, that for the first four and a half months of 2004, Sentinel operated with a net loss of $197,917.00.[124] Finally, the report showed that as of May 18, 2004, Sentinel had total corporate assets of $1,389,682. Thus, taking into account the cash deficiency in the pooled fiduciary account (which is reflected as an accounts payable), the report determined that Sentinel was insolvent in an amount of at least $6,225,445 as of May 18, 2004.[125]

On June 17, 2004, the Commissioner and members of his staff met with Appellant Danny Bates, and his attorney, Carroll Kilgore.[126] At that meeting, Messrs. Bates and Kilgore were presented with a copy of the Report for their review and given the opportunity to discuss the Report with the Commissioner and his staff. Messrs. Bates and Kilgore were also given the opportunity to submit a written response to the Report prior to the Report being made public and/or any action taken by the Commissioner with respect to the Report. Neither Mr. Bates nor Mr. Kilgore had any substantive comments to make with respect to the Report during the meeting with the Commissioner, nor did they submit any written response.[127]

In light of the Report's determination that Sentinel was insolvent in an amount of at least $6,225,000; that Sentinel did not have sufficient liquid assets to pay off its bondholders and creditors; did not have a viable plan for the infusion of sufficient capital to eliminate the $7.6-

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[124]AR. Vol. III, 634.

[125]AR. Vol. III, 633. This insolvency does not include the $861,107.11 in bond principal and interest checks discussed, *supra*, which increases the fiduciary cash deficiency, and would increase the insolvency by a corresponding amount.

[126]AR. Vol. III, 601.

[127]*Id.*

$8.4 million cash deficiency in the pooled fiduciary account; and the record as a whole, the Commissioner determined that liquidation of Sentinel in accordance with the provisions of Tenn. Code Ann. §§ 45-2-1502(c)(2) and 1504 was necessary and appropriate.[128] Accordingly, on June 18, 2004, the Commissioner issued a Notice of Liquidation of Sentinel Trust Company.[129]

2. McCullough Affidavit

In support of his response in opposition to the petition for writs of certiorari and supersedeas, the Commissioner submitted the affidavit of Wade McCullough, an Examiner/Trust Specialist for the Department of Financial Institutions.[130] In addition to assisting in several of the examinations of Sentinel, Mr. McCullough had assisted the Receiver, particularly in analyzing Sentinel's records to determine the company's true financial status.[131] Mr. McCullough had determined, among other things, that Sentinel had listed over $1 million in accounts receivable in fees and expenses advanced from a number of previously defaulted bond issues for which there was no documentary support.[132] Moreover, Sentinel's records showed that each of these defaulted bond issues had a positive cash balance, which in most instances was in excess of the listed account receivable. Upon further review of Sentinel's records, Mr. McCullough

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[128]AR. Vol. III, 644-646.

[129]*Id.*

[130]TR, Vol. IV, 449-456.

[131]*Id.* at 452.

[132]*Id.* at 453-54.

determined that all of these fees and expenses had already been paid and that none of these defaulted bond issues owed any funds to Sentinel.[133]

Mr. McCullough also testified in his affidavit that he had identified a number of bond issues allegedly owing fees to Sentinel, where Sentinel's management capitalized and recognized those fees at a time when none of these issues had a positive cash balance.[134] In other words, these bond issues had no funds on deposit in the pooled fiduciary account. Specifically, in April, 2004, at a time when Sentinel's operations and financial conditions were being strictly scrutinized by the Department, Sentinel's management transferred over $82,000 from the pooled fiduciary account into Sentinel's corporate account, ostensibly as default fees against these bond issues for January and February, 2004.[135]

3. March 29-April 1, 2005 Hearing

At the hearing on Appellants' petition for writ of certiorari, Appellants were allowed to present additional evidence on the question of whether the Commissioner exceeded his jurisdiction or acted illegally, arbitrarily, or capriciously. Accordingly, Appellants presented the testimony of four witnesses: David Lemke, an attorney with Waller, Lansden, Dortch & Davis; Beverly Horner, a CPA with Kraft Bros.; Richard Whisenant; a CPA; and, Appellant Danny Bates.

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[133] *Id.*

[134] *Id.* at 454.

[135] *Id.* Approximately two weeks after he transferred the $82,000 out of the pooled fiduciary account and into Sentinel's corporate account, President Bates admitted to the Commissioner that there was, by his own accounting, a $7.25 million cash deficiency in the pooled fiduciary account. *See* fn. 103, *supra.*

a. David Lemke Testimony

Mr. Lemke, an attorney with the firm of Waller, Lansden, Dortch & Davis ("the law firm"), testified that he and other members of the law firm had been representing Sentinel Trust Company since late 1997 in a variety of different matters with respect to defaulted bond issues.[136] However, the firm was not engaged to represent Sentinel in its dealings with the Commissioner until early 2004.[137] Shortly thereafter, in April 2004, Mr. Lemke testified that he became aware of how Sentinel was funding shortfalls in its defaulted bond issues, primarily as a result of Sentinel's Executive Vice-President Paul Williams asking for legal advice on the issue.[138]

In response to this request for legal advice, the law firm prepared a memorandum in which it advised that

> Sentinel should not advance funds from other trust accounts unless it can document that it has authority to do so under applicable state law and that such advance is fair to each of the trusts involved. If it determines an advance is required in order to protect the trust estate, it is likely that obtaining a loan can withstand judicial authority only if the funding is derived from its own corporate funds and not trust assets.[139]

Mr. Lemke further testified that the law firm was not aware of, nor had it been able to find any state law that would authorize Sentinel to advance funds from other trust accounts. Moreover, Mr. Lemke testified this in his experience, it was the custom and practice in the bond industry that if there was a defaulted bond issue and no cash available like a debt service reserve

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[136]TE, Vol. XII, 48, 68.

[137]*Id.* at 48-49.

[138]*Id.* at 68-69.

[139]*Id.* at 70-71; Exh. 4.

fund or some pool of cash attributable to that bond issue that the trust company could use to fund expenses, the trust company would use its own corporate funds, because when the collateral was liquidated or the bonds paid back, the trust company would have a priority charging lien on any proceeds.[140] However, Mr. Lemke testified that Sentinel did not use its own corporate funds, but instead used pooled trust funds — which the law firm advised Sentinel not to do once they were made aware of it.[141] Mr. Lemke also testified that it was his understanding the reason why Sentinel used the pooled trust funds and not corporate funds was because the company was under-capitalized and simply did have the corporate funds necessary to fund the expenses on all the defaulted bond issues.[142]

With respect to the cash deficiency in the pooled fiduciary account, Mr. Lemke testified that the law firm had internally identified a shortfall in the amount of six to eight million dollars and that it was his understanding this shortfall was made up of real dollars, and not simply accounting figures.[143] Mr. Lemke further testified that of that amount, he had been able to identify approximately two and a half million that was attributable to expenses incurred on behalf of defaulted bond issues that had run out of cash, but whose assets had not yet been liquidated.[144]

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[140]TE, Vol. XII, 56, 83-84.

[141]*Id.* at 84.

[142]*Id.* at 72-73, 86.

[143]*Id.* at 53, 74.

[144]*Id.* at 55.

Mr. Lemke also testified that if Sentinel had used corporate funds instead of pooled trust funds for these expenses, then the amount of the shortfall would be less that two and a half million.[145]

More important, however, was Mr. Lemke's testimony concerning the remainder of the shortfall. Mr. Lemke testified that one of the reasons why the law firm recommended that the Sentinel Board of Directors remove Danny Bates as President and replace him with a neutral third party, was the fact that the explanations Danny Bates had provided to the firm about the rest of the shortfall did not make sense and were not acceptable.[146] For example, Mr. Lemke testified one of Mr. Bates' explanations was that a large portion of the shortfall was "fees and expenses that he simply forgot to bill or somehow had been accrued and had not yet been charged through" with respect to a series of bond issues (Sun Health Care) that had been sold to another entity, American Senior Living. Mr. Lemke testified that in addition to doubting the veracity of Mr. Bates' claims, he knew that there was no way these fees and expenses could be charged to American Senior Living because Mr. Bates had already settled up with them.[147]

Mr. Lemke also testified that Mr. Bates had claimed a large part of the shortfall was attributable to Sentinel's fees and expenses that it was accruing on the defaulted bond issues. However, Mr. Lemke testified that this explanation did not make any sense because that only meant fees were being accrued and cash was not actually being taken out of the pooled trust fund.

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[145] *Id.* at 89-90.

[146] TE, Vol. XII, 62-66, 78-80.

[147] *Id.* at 78-79.

If, as Mr. Lemke noted, cash was actually being taken out, that would have only resulted in the shortfall being larger that it already was.[148]

Finally, Mr. Lemke testified that the law firm had ultimately concluded that Mr. Bates was really in control of the entire company and the board knew very little about what was going on, and that if the company were going to survive, "it needed somebody very credible dealing with the commissioner who could look at the books and records and come up with an explanation we could then accept . . .."[149]

b. Richard Whisenant Testimony

Mr. Whisenant, a CPA with Horne CPA Group, testified, in his opinion, as to the solvency or insolvency of Sentinel as of May 18, 2005, when the Commissioner took possession of the company. Essentially, Mr. Whisenant testified that, in his opinion as a CPA, Sentinel was not insolvent because it "was meeting its obligations to its bondholders and making the collections from the bond issuers and . . . trying to pursue those issuers who were in default."[150] However, Mr. Whisenant admitted that in arriving at this opinion the only documents that he had reviewed were: (1) te audit prepared by Charles Welch for period ending 12-31-01; (2) the audit prepared by Kraft Bros. for period ending 12-31-02; (3) the petition for writ of certiorari and attachments thereto; (4) the notice of possession filed by the Commissioner; and (5) the affidavits of Danny Bates filed in chancery court and in federal court.[151] Mr. Whisenant further admitted

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[148] *Id.* at 80.

[149] *Id.*

[150] TE, Vol. XII, 120.

[151] *Id.* at 120-121.

that he did not review the June 15, 2005 report of the Receiver or any of the administrative record filed with the court, as well as any of the actual books and records of Sentinel.[152]

While Mr. Whisenant testified that it was his understanding that the deficiency in the pooled fiduciary account was primarily attributable to expenses incurred on behalf of defaulted bond issues, as well as Sentinel's accrued fees and interest charges, he admitted that he did not have independent confirmation of this information and that his testimony was based solely upon Danny Bates' affidavits.[153] Mr. Whisenant further testified that he had never reviewed Sentinel's corporate policies and that his knowledge and understanding of Sentinel's operating history and procedures was again, based upon Danny Bates' affidavit. As such, he admitted that the only basis he had for concluding that Sentinel could use the funds in the pooled fiduciary account for any purpose, including meeting its monthly obligations, was Mr. Bates' affidavits. Moreover, with respect to the deficiency in the pooled fiduciary account, Mr. Whisenant admitted that if the proceeds from the liquidation of collateral on the defaulted bond issues was not enough to cover that deficiency, Sentinel would be in the position of having to reimburse the pooled trust fund for that money.[154]

Finally, Mr. Whisenant admitted that his testimony as to the solvency of Sentinel as of May 18, 2004, was not relevant to the Commissioner's decision to take possession of Sentinel, because the Commissioner did not make any determination as to the solvency of the company

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[152]*Id.* at 122.

[153]*Id.* at 129-131.

[154]TE, Vol. XII, 143, 154.

until June 18, 2004, after he had received the Receiver's report that Mr. Whisenant had not reviewed.[155]

c. Beverly Horner Testimony

Ms. Horner testified that she was a CPA with Kraft Bros., and that she handled the audit of Sentinel for the period ending 12-31-02.[156] Ms. Horner testified that in doing the audit, Kraft Bros. did not feel like it was "able to give an opinion that those receivables were fairly stated because we weren't able to verify those - - we weren't able to perform the audit procedures on those we felt would be necessary to include them in an opinion."[157] Ms. Horner further testified that Kraft Bros. was unable to complete its audit of Sentinel for the period ending 12-31-03 for the same reason, *i.e.*, inability to verify the accounts receivable in the trust account.[158]

d. Danny Bates Testimony

The final witness presented by Appellants was Danny Bates, President and sole shareholder of Sentinel. Mr. Bates testified that he first acquired what is now Sentinel Trust Company in either 1986 or 1987.[159] He further testified that prior to Sentinel being brought under the regulatory authority of the Commissioner of Financial Institutions as a result of the 1999 legislation, he was the president and sole director of Sentinel and ran everything.[160]

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[155] *Id.* at 153.

[156] TE, Vol. XII, 157.

[157] *Id.* at 160.

[158] TE, Vol. XII, 161-163.

[159] TE, Vol. XII, 168.

[160] TE, Vol. XII, 166.

Mr. Bates testified that he (as Sentinel) first became involved in the corporate trust business towards the end of 1992. Sentinel experienced its first defaulted corporate bond issue in 1996, with the default of a number of bond issues referred to as the Namor bonds. The bulk of Sentinel's defaulted bond issues, approximately 60-70, occurred in 1999.[161]

With respect to the defaulted bond issues that Sentinel had worked out prior to the Commissioner taking possession, Mr. Bates first testified on direct examination that Sentinel recovered *all of its fees and expenses*, including the one and a half percent per month compounded interest, and that it distributed approximately sixty-six ($66) million dollars to the bondholders.[162] However, on cross-examination, Mr. Bates admitted that Sentinel had to recognize over $180,000 in losses from two defaulted bond issues in 2000.[163] Then, contrary to his earlier testimony, Mr. Bates further admitted on re-direct that Sentinel had actually written off unreimbursed expenses on three or four defaulted bond issues.[164]

Mr. Bates gave similarly conflicting testimony on several other issues. For example, he first testified on direct that Sentinel's bookkeeping practices were that unless a defaulted bond issue had a positive balance, *i.e.* real cash on deposit, Sentinel would not pay itself its fees. Instead, it would allow the fees and charges to accrue until such time as the account actually had cash in it to make a distribution to the corporation.[165] However, on cross-examination, Mr. Bates

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[161] *Id.* at 178-179.

[162] *Id.* at 204-205.

[163] TE, Vol. XIII, 329; AR, Vol. I, 133.

[164] TE, Vol. XIII, 440.

[165] TE, Vol. XII, 206-07, 209.

examiners that the settlement had been "accomplished with a loan from Sentinel Services Corporation . . . an affiliated company wholly owned by President Bates."[169]

Mr. Bates then changed his testimony and stated that the securities were owned by himself and Sentinel Services Corporation, but held in Sentinel Trust Company's safekeeping account in book entry form.[170] When repeatedly asked in whose name or for whose benefit the securities were held, Mr. Bates answered that while the securities would have been in the name of the depository trust company because they were in street name, that company would have known "Sentinel Trust Company as the holder of the safe-keeping account as the owner, and Sentinel Trust Company knew Sentinel Services and myself as the beneficial owner - - or myself."[171] Additionally, although Mr. Bates testified on direct that he liquidated these securities in order to pay the settlement in 2001, he later admitted under cross that he had actually liquidated the securities in 1999, almost two years before.[172]

Perhaps the most significant and relevant testimony of Mr. Bates was his testimony concerning Sentinel's role as trustee and how he viewed the "trust department" and its operation. With respect to Sentinel's role as trustee on a corporate bond issue, Mr. Bates testified it was his understanding that all the actions of the trustee were generally governed by the specific indenture which governed that issue.[173] He further testified that virtually all of the indentures used by

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[169]*Id.* at 287-88.

[170]*Id.*

[171]*Id.* at 307-308.

[172]TE, Vol. XIII, 30-307.

[173]TE, Vol. XII, 175.

Sentinel were based upon a model form and that this form specifically provided that with respect to each fund set up for a bond issue, "the monies within that fund were to be applied solely for the purposes for which that fund was organized."[174] With respect to defaulted bond issues, he testified his view was that, as trustee, they had a duty and obligation to the bondholders to try to protect the underlying collateral and enforce their rights until the collateral could be liquidated and the indenture was extinguished through the payoff of the bonds.[175]

As to the trust department itself, Mr. Bates testified that it did not have any accounts, just assets and liabilities. The "assets," Mr. Bates testified, were the cash, securities, receivables, real property or other investments *attributable to the individual trust accounts of each bond issue*, which collectively comprised the "liabilities" of the trust department. Mr. Bates further admitted that the monies deposited in the individual trust accounts were to be held in trust and applied only for the specific purpose of that account (*e.g.*, principal and interest payments). Mr. Bates specifically admitted that such monies deposited were not to be used to pay for the third-party expenses of another bond issue.[176]

However, Mr. Bates also admitted that the trust department had these assets available as a "funding crutch for the duration", *i.e.*, the workout of a defaulted bond issue.[177] Additionally, **Mr. Bates specifically admitted on cross- examination that he used the "total cash held by the trust department" — the monies deposited in trust to be used for the purposes**

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[174]TE, Vol. XIII, 333-336.

[175]TE, Vol. XII, 203.

[176]TE, Vol. XIII, 344-346.

[177]TE, Vol. XII, 205.

specified in the indenture — to pay the expenses of unrelated defaulted bond issues when they did not have any money.[178]

Finally, when asked about his response to the Department's inquiry as to Sentinel's "rationale for not returning to bondholders all funds received from the liquidation of collateral than exceeds Sentinel's expenses," he confirmed that he did not have any rationale; that Sentinel's fee schedules were set up to permit the company to make a profit on all activity under fee, not one transaction at a time; and, that it was "possible for the company to lose money on a particular transaction or account and make up for it on other accounts or transactions."[179] He subsequently testified it was his personal opinion that when collateral of a defaulted bond issue was liquidated, any proceeds in excess of Sentinel's accrued fees and charges should be applied to reduce the cash deficiency in the pooled fiduciary account instead of being paid to the bondholders, because "I don't think there's any justice or equity in taxing the holders of performing bonds for the expenses of administering defaulted bonds."[180]

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[178]TE, Vol. XIII, 343-344.

[179]TE, Vol.XIII, 349-350.

[180]*Id.* at 406-407. This testimony is contrary to Mr. Bates' testimony on direct and re-direct that with respect to the defaulted bond issues Sentinel had worked out before the Commissioner took possession, any excess funds were remitted to the bondholders. *See* TE, Vol. XII, 203-25 and TE, Vol. XIII, 453.

STANDARD OF REVIEW

The scope of review under the common law writ is very narrow. The common law writ does not permit the reviewing court to inquire into the intrinsic correctness of the inferior board or tribunal's judgment as to the law or the facts.[181] Rather, judicial review is of the manner in which the decision of the inferior board or tribunal was reached and not the correctness of the decision itself.[182] Thus, the scope of review covers only an inquiry into whether the inferior board or tribunal has exceeded its jurisdiction, followed an unlawful procedure, acted illegally, fraudulently, or arbitrarily or acted without material evidence to support its decision.[183] "Exceeding the jurisdiction conferred" and "acting illegally" both refer to actions that are beyond, and not within, the jurisdiction of the inferior board or tribunal.[184] Moreover, illegal

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[181] *Cooper v. Williamson County Bd. of Educ.*, 746 S.W.2d at 176, 179 (Tenn. 1987); *McCord v. Nashville, C & St. L. Ry.*, 187 Tenn. 277, 294, 213 S.W.2d 196, 204 (1948); *Littles v. Campbell*, 97 S.W.3d 568, 571 (Tenn. Ct. App. 2002); *Hall v. McLesky*, 83 S.W.3d 752, 757 (Tenn.Ct.App. 2001); *Yokley v. State*, 632 S.W.2d at 126 (Tenn. Ct. App. 1981). *See also Pack v. Royal-Globe Ins. Companies*, 224 Tenn. at 456, 457 S.W.2d at 25 (1970); *Henry v. Board of Claims*, 638 S.W.2d 825, 827 (Tenn. Ct. App. 1982), *cert. denied* (1982)(Chancellor's actions in reviewing intrinsic correction of Board's decision exceeded power and jurisdiction under common law writ of certiorari); and *Yearwood v. Industrial Develop. Bd. of City of White House*, 648 S.W.2d 944, 946 (Tenn. Ct. App. 1982) *cert. denied* (1983)("The writ has never been employed to inquire into the correctness of the judgment rendered where the court had jurisdiction and was therefore competent.").

[182] *Powell v. Parole Eligibility Review Board*, 879 S.W.2d at 873 (Tenn. Ct. App. 1994). *See also State ex rel. McMorrow v. Hunt*, 137 Tenn. at 250-51, 192 S.W. at 933 (1916); *Davis v. Rose*, App. No. 01A01-9610-CH-00494 (1997 WL 83671), slip op. at 2 (Feb. 28, 1987)(held that categories of "illegal, fraudulent or arbitrary, or in excess of its jurisdiction" all stand for the principle that what is being challenged is not the intrinsic correctness of the lower court's decision, but some fundamental flaw in the manner in which that decision was reached)(copy attached); and *Fox v. Tennessee Board of Paroles*, App. No. 01A019506CH00263 (1995 WL 681135), slip op. at 2 (Nov. 17, 1995)(common law writ permits court to review manner in which board reached its decision but not to review intrinsic correctness of decision itself)(copy attached).

[183] *Fallin v. Knox County Bd. of Comm'rs*, 656 S.W.2d 338, 342-343 (Tenn. 1983); *Hutcherson v. Lauderdale County Bd. of Zoning App.*, 121 S.W.3d 372, 375 (Tenn. Ct. App. 2002); *421 Corp. v. Metropolitan Gov't*, 36 S.W.3d 469, 474 (Tenn.Ct.App. 2000); *Powell v. Parole Eligibility Review Board*, 879 S.W.2d 871, 873 (Tenn. Ct. App. 1994), *cert. denied* (1994)(citing *Yokley v. State*, 632 S.W.2d 123 (Tenn. Ct. App. 1981).

[184] "*Pack v. Royal-Globe Ins. Companies*, 224 Tenn. 452, 456, 457 S.W.2d 19, 25 (1970).

actions subject to correction through a common-law writ of certiorari must rise to the level of a fundamental illegality,[185] or a failure to proceed according to the essential requirements of the law.[186]

Additionally, judicial review under the common-law writ is limited to the record made before the board or inferior tribunal to determine if there is any material or substantial evidence to support the action of the board or inferior tribunal or if it exceeded its jurisdiction or acted in an illegal, arbitrary or capricious manner.[187] The reviewing court does not determine any disputed question of fact or weigh any evidence, nor may it engage in weighing or balancing the evidence when determining whether the board's decision rests on any material or substantial evidence.[188] Further, the reviewing court does not substitute its judgment for that of the board or inferior tribunal.[189]

"Material evidence" has been defined as that "material in question, which must necessarily enter into the consideration of the controversy and by itself, or in connection with the

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[185]*State ex rel. McMorrow v. Hunt*, 137 Tenn. 243, 249, 192 S.W. 931, 933 (1916).

[186]*Taylor v. Continental Tenn. Lines, Inc.,* 204 Tenn. 556, 560, 322 S.W.2d 425, 426-27 (1959); *Gatlinburg Beer Regulation Comm. v. Ogle*, 185 Tenn. 482, 486, 206 S.W.2d 891, 893 (1947).

[187]*Cooper v. Williamson County Bd. of Educ.*, 746 S.W.2d 176, 179 (Tenn. 1987); *Davison v. Carr*, 659 S.W.2d 361, 363 (Tenn. 1983); *City of Chattanooga v. Tennessee Alcoholic Beverage Commission*, 525 S.W.2d 470, 478 (Tenn. 1975); *Hoover Motor Express v. Railroad and Public Utilities Commission*, 195 Tenn. 593, 604-605, 261 S.W.2d 233, 238 (1953); and, *Houston v. Memphis and Shelby County Bd. of Adjustment*, 488 S.W.2d 387, 388 (Tenn. Ct. App. 1972).

[188]*Watts v. Civil Serv. Bd. for Columbia,* 606 S.W.2d 274, 277 (Tenn. 1980); *Tennessee Cartage Co. v. Pharr*, 184 Tenn. 414, 419, 199 S.W.2d 119, 121 (1947); *Case v. Shelby County Civil Serv. Merit Bd.*, 98 S.W.3d 167, 172 (Tenn.Ct.App. 2002); *Hoover, Inc. v. Metropolitan Bd. of Zoning App.*, 924 S.W.2d 900, 904 (Tenn.Ct.App. 1996).

[189]*421 Corp. v. Metropolitan Gov't*, 36 S.W.3d at 474; *Whittemore v. Brentwood Planning Comm'n*, 835 S.W.2d 11, 15 (Tenn. Ct. App. 1992).

other evidence, be determinative of the case."[190] "Substantial evidence" has been defined as such evidence as reasonable minds might accept as adequate to support a conclusion.[191] "Substantial evidence" has also been defined as being "something less than the weight of the evidence, and the possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency's finding from being supported by substantial evidence."[192]

Thus, Tennessee courts have held that under the common law writ of certiorari

> it matters little that there may be evidence to support a conclusion contrary to that reached by the Board. Its makes no difference if the Board's decision is or is not correct. So long as there is any material and substantial evidence to support the Board's decision, the Board's decision will be affirmed.[193]

As such, an erroneous decision of the interior board or tribunal, or a misapplication of a principle of law, absent more, is not considered illegal, arbitrary or capricious.[194]

The specific legal arguments raised by Appellants should be considered with this standard of review in mind.

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[190] *Knoxville Traction Co. v. Brown*, 115 Tenn. 323, 331, 89 S.W. 319, 321 (1905); *Fuller v. Tennessee-Carolina Transportation Co.*, 63 Tenn.App. 330, 338, 471 S.W.2d 953, 956 (1970).

[191] *Rice Bottling Co. v. Humphries*, 213 Tenn. 8, 11, 372 S.W.2d 170, 172 (1963).

[192] *Hendricks v. Metropolitan Employee Benefit Board*, App. No. 01A01-9203CH00130 (1992 WL 279880), slip op. at 3 (Oct. 14, 1992).

[193] *Id.*

[194] *See Henry v. Board of Claims,* 638 S.W.2d at 827 (1982)("We do not believe that a misapplication of a principle of law by the Board will invoke a right to review of its findings by the common law writ of certiorari."); *Purcell Enterprises, Inc. v. State*, 631 S.W.2d 401, 405 (Tenn. Ct. App. 1981), *cert. denied* (1982)("interpretation by the board of the equitable adjustments clause was erroneous, but not arbitrary, capricious or illegal . . . the board of claims either made a mistake of fact or a mistake of law, or both. From such erroneous interpretation, . . . there is no review in the courts pursuant to the writ of certiorari."); and *Yokley v. State*, 632 S.W.2d at 127 (Tenn. Ct. App. 1981)(misapplication or error of law is not illegal, arbitary or capricious).

ARGUMENT

I. This Case Is Moot As There is No Effectual Relief That Could Be Granted.

Appellants take the position that because "[t]here is in this record no evidence that any of Sentinel's assets have been conveyed away beyond redemption," this Court can order undone what has been ordered done.[195] Accordingly, Appellants seek either a final order from this Court or an order directing the trial court to enter an order, that seeks to assure the restoration of the *status quo ante.*[196] In other words, Appellants want this Court to order the Commissioner to return Sentinel to the status is was before possession occurred on May 18, 2004.

The trial court found, however, that Appellants had delayed so long in bringing their factual challenge to the Commissioner's decisions to take possession and liquidate Sentinel that while the company could have been put back together in the summer of 2004, it can no longer be put back together. As such, the trial court found that the case was moot, relying upon the Tennessee Supreme Court's holding in *Boyce v. Williams*, 389 S.W.2d 272 (Tenn. 1965). Appellants argue that *Boyce v. Williams* is but "an anomaly — it should not be taken as an inspiration to intentionally repeat ancient mistakes."[197]

Contrary to this assertion, *Boyce v. Williams* is not an anomaly, but well-established precedent that Tennessee appellate courts have relied upon in defining the scope of their

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[195]Appellants' brief at 58.

[196]*Id.* at 61-62.

[197]*Id.* at 59.

appellate jurisdiction. Moreover, such an assertion ignores the fact that *Boyce* is based upon earlier well-established law, as noted by the Supreme Court:

> The rule is well established that review proceedings are not allowed for the purpose of setting abstract questions, but only to correct errors injuriously affecting the rights of some party to the litigation. Accordingly, an appeal or error proceeding will be dismissed if the question presented by it is fictitious, or has [been] become moot or academic, or if, without any fault of the appellee or defendant in error, an event has occurred which makes a determination of it unnecessary or renders it impossible for an appellate court to grant effectual relief.[198]

Furthermore, the record clearly supports the trial court's determination that Sentinel Trust Company is but an empty shell and there is no effectual relief that can be granted. By the time the factual hearing occurred in late March, 2005, the liquidation of Sentinel had been ongoing for approximately eleven months. During the course of the liquidation, all of Sentinel's non-defaulted bond issues, along with the fiduciary assets belonging to those issues, had been transferred to successor trustees, leaving only seven defaulted bond issues.[199] By the time of the hearing, three of those bond issues had been worked out and the other four defaulted bond issues were the only remaining business of Sentinel Trust Company.[200]

These actions — the transfer of bond issues to successor trustees and liquidation of collateral — are clearly not actions that can be undone, regardless of Appellants' assertions to the contrary. Consequently, there simply is no effectual or practical relief that this Court can grant and this appeal is moot and should be dismissed.

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[198] *Boyce*, 389 S.W.2d at 278 (internal citations omitted).

[199] TE, Vol. XII, 249.

[200] TE, Vol. XIII, 423-430; Exh. 33.

II. The Commissioner Did Not Exceed His Jurisdiction Or Act Illegally In Taking Possession Of Sentinel Trust Company.

Appellants' case, both before this Court and the trial court, rests primarily upon a statutory construction argument, and in particular, the proper interpretation and application of Tenn. Code Ann. §§ 45-1-124 and 45-2-1502. Appellants take the position that "no statute provides that the term "bank" includes "trust company" with reference to any other provisions of the Tennessee Banking Act" and, therefore, the Commissioner has no authority to exercise any of his "bank regulatory powers" against Sentinel, a non-banking trust company, including Tenn. Code Ann. § 45-2-1502 which authorizes the Commissioner to take possession of a state bank in certain circumstances.[201] As such, Appellants assert that the Commissioner exceeded his jurisdiction and/or acted illegally when he took possession of Sentinel pursuant to the provisions of Tenn. Code Ann. § 45-2-1502.

The trial court rejected this argument, finding that "Tennessee banking laws contained in Chapters 1 and 2 of Title 45 fully apply to trust companies and that these statutes are constitutional."[202] The trial court further found that the Commissioner had acted with express statutory authority in taking possession and determining to liquidate Sentinel Trust Company.[203] These findings by the trial court are fully supported both by the plain language of the statutes, as well as their legislative history.

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[201] TR, Vol. I, 1-22.

[202] *Id.* at p. 12.

[203] *Id.* at p. 10.

The Tennessee Banking Act was first adopted by the General Assembly in 1969 and only directed that all state banks be operated in accordance with its provisions.[204] In 1980, the General Assembly amended the Act to expand the scope of its application, providing as follows:

> provided, however, a state bank or trust company whose purposes and powers are limited to fiduciary purposes and powers shall be subject only to the provisions pertaining to fiduciaries in Chapters 1 through 11 of this title and such other provisions of said chapters as the Commissioner determines are reasonably necessary for the sound operation of such banks or trust companies.[205]

The General Assembly further provided that "[n]o trust company hereafter may be incorporated or be qualified to act as a fiduciary unless it is incorporated under Chapters 1 through 11 of this title, or the laws governing national banking associations."[206]

In 1999, the General Assembly once again amended the Act to specifically make trust companies subject to all of its provisions, and not just those pertaining to fiduciaries. Section 3 of Chapter 112 of the Public Acts of 1999 amended Tenn. Code Ann. § 45-1-124(b) by deleting that subsection and substituting the following:

> (b) To the full extent consistent with such rights, liabilities and penalties, all state banks and, to the extent applicable, all banks, shall hereafter be operated in accordance with the provisions of this chapter and Chapter 2 of this title. ***Unless the Commissioner determines otherwise, the provisions of Title 45, Chapters 1 and 2 and the rules thereof shall also apply to the operation and regulation of state trust companies and banks whose purposes and powers are limited to fiduciary purposes and powers.***

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[204]TR, Vol. V, 543-546.

[205]*Id.* at 547 - 548, codified at Tenn. Code Ann. § 45-1-124.

[206]*Id.* at § 4.

Section 4 of Chapter 112 further amended Tenn. Code Ann. § 45-1-124 to add the following new subsection:

> ( ) The charter of a trust company granted by the commissioner shall not be void due to the enactment of any amendment or repeal of the laws under which it was formed if such trust company is in operation, as determined by the commissioner, on July 1, 1999.
>
> ( ) Companies engaged in activities subject to Title 45, Chapters 1 and 2, on July 1, 1999, but formed, as determined by the commissioner, prior to the enactment of Chapter 620 of the Public Acts of 1980 and not previously subject to regulation by the commissioner may continue to act as a fiduciary without submitting an application. ***However, such entities shall otherwise be fully subject to Chapters 1 and 2.***
>
> ( ) Companies authorized by their charter, prior to the enactment of Chapter 620, to engage in fiduciary activities, but not engaging in fiduciary activities on July 1, 1999, then must file the appropriate application to establish a trust company and ***then fully comply with Chapters 1 and 2.***
>
> ( ) ***All state trust companies operating on July 1, 1999, shall have such period of time as the commissioner determines to be reasonable and prudent to conform to the requirements of Chapters 1 and 2 and the regulations thereunder, but such period shall not exceed three (3) years from July 1, 1999.*** During this period of time, to conform to the requirements of Chapters 1 and 2, the commissioner may conduct examinations at such company's expenses, and apply the requirements of Chapters 1 and 2 as deemed appropriate.[207]

The most fundamental rule of statutory construction is that ***the intention of the legislature must prevail.***[208] Thus, courts must ascertain and then give the fullest possible effect

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[207]TR, Vol. V, 549-556 (emphasis added).

[208]*McGee v. Best*, 106 S.W.3d 48, 64 (Tenn.Ct.App.), *p.t.a. denied* (2002)("The rule of statutory construction to which all others must yield is that the intention of the legislature must prevail."). *See also, Southern v. Beeler*, 183 Tenn. 272, 195 S.W.2d 857 (1946); *Mangrum v. Owens*, 917 S.W.2d 244, 246 (Tenn.Ct.App. 1995); *City of Humboldt v. Morris*, 579 S.W.2d 860, 863 (Tenn.Ct.App. 1978).

to the General Assembly's purpose in enacting a statute as reflected in the statute's language.[209] Furthermore, the Tennessee Supreme Court has held that where the language of a statute is clear and unambiguous, the courts must interpret the statute as written,[210] rather than using the tools of construction to give the statute another meaning.[211] Here, the language of Tenn. Code Ann. § 45-2-124 clearly and unambiguously reflects the Legislature's intent that all provisions of chapters 1 and 2 of the Banking Act apply to the operation of trust companies in this state.

Appellants, however, would have this Court ignore the clear language of Tenn. Code Ann. § 45-1-124, and instead focus solely on the definition of "state bank" to the exclusion of all other provisions of the Bank Act. Because that definition does not include trust companies, Appellants argue that the Commissioner cannot assert bank regulatory authority over a trust company. In particular, Appellants assert that the Commissioner has no authority to take possession of a trust company under Tenn. Code Ann. § 45-1-1502, because that statute only speaks in terms of a "state bank."[212]

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[209] *Jones v. Garrett*, 92 S.W.3d 835, 839 (Tenn. 2002); *Robinson v. LeCorps*, 83 S.W.3d 718, 722 (Tenn. 2002).

[210] *Kradel v. Piper Indus., Inc.*, 60 S.W.3d 744, 749 (Tenn. 2001); *ATS Southeast, Inc., v. Carrier Corp.*, 18 S.W.3d 626, 629-30 (Tenn. 2000); *Lavin v. Jordon*, 16 S.W.3d 362, 365 (Tenn. 2000).

[211] *Limbaugh v. Coffee Med. Ctr.*, 59 S.W.3d 73, 83 (Tenn. 2001); *Gleaves v. Checker Cab Transit Corp.*, 15 S.W.3d 799, 803 (Tenn. 2000).

[212] Tenn. Code Ann. § 45-2-1502 provides in part as follows:

> (a) The commissioner may take possession of a state bank if, after a hearing, the commissioner finds:
>
> (1) Its capital is impaired or it is otherwise in an unsound condition;
>
> (2) Its business is being conducted in an unlawful or unsound manner;
>
> (3) It is unable to continue normal operations; or
>
> (4) Its examination has been obstructed or impeded.

This argument is directly contrary, however, to the clearly expressed intent of the General Assembly as set forth in Chapter 112. Generally, the search for a statute's meaning should begin with the words of the statute itself.[213] The courts must give these words their natural and ordinary meaning unless the context in which they are used requires otherwise.[214] Further, because words are known by the company they keep,[215] courts should construe a statute's words in the context of the entire statute and in light of the statute's general purpose. Additionally, courts have a duty to construe a statute so that no part will be inoperative, superfluous, void or insignificant, and so that no section will destroy another.[216] Tenn. Code Ann. § 45-1-124 specifically states that "***the provisions of Title 45, Chapters 1 and 2 and the rules thereof shall also apply to the operation and regulation of state trust companies*** and banks whose purposes and powers are limited to fiduciary purposes and powers."[217] Tenn. Code Ann. § 45-2-1502 clearly is a provision contained within Chapter 2 of Title 45 and, therefore, applies to the operation and regulation of Sentinel Trust Company. The language of Tenn. Code Ann. § 45-2-

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* * *

(c)(1) If, in the opinion of the commissioner, an emergency exists which will result in serious losses to the depositors, the commissioner may take possession of a state bank without a prior hearing. Any person aggrieved and directly affected by this action of the commission may have a review by certiorari as provided in title 27, chapter 9.

[213] *Blankenship v. Estate of Bain*, 5 S.W.3d 647, 651 (Tenn. 1999); *Freedom Broadcasting of Tenn., Inc. v. Tennessee Dep't of Revenue*, 83 S.W.3d 776, 781 (Tenn. Ct. App. 2002).

[214] *Nashville Golf & Athletic Club v. Huddleston*, 837 S.W.2d 49, 53 (Tenn. 1992); *Lockheed Martin Energy Sys. v. Johnson*, 78 S.W.3d 918, 923 (Tenn.Ct.App. 2002).

[215] *State ex rel. Comm'r of Transp. v. Medicine Bird Black Bear White Eagle*, 63 S.W.3d 734, 754-55 (Tenn.Ct.App. 2001).

[216] *Mangrum v. Owens*, 917 S.W.2d at 246 (citing *City of Caryville v. Campbell County*, 660 S.W.2d 510, 512 (Tenn.Ct.App., 1983); *Tidwell v. Collins*, 522 S.W.2d 674, 676 (Tenn. 1975)).

[217] *See* Tenn. Code Ann. § 45-2-124(b) (emphasis added).

124 is plain and unambiguous and clearly expresses the Legislature's intent and, therefore, no further analysis is needed.

However, the courts have held that when the plain language of a statute is reasonably capable of conveying more than one meaning, the statute is rendered ambiguous, and courts must then look to the entire statute, the statutory scheme in which the statute appears,[218] as well as the "subject matter [of the statute], the object and reach of the statute, the wrong or evil which it seeks to remedy or prevent, and the purpose sought to be accomplished in its enactment" to ascertain the legislature's intent.[219] While the Commissioner believes the statute to be unambiguous, to the extent the interplay of Tenn. Code Ann. § 45-1-124 with the provisions of Tenn. Code Ann. § 45-2-1502 creates any ambiguity, then it is appropriate for this Court to consider, among other things the legislative history of Tenn. Code Ann. § 45-2-124 (Chapter 112 of the Public Acts of 1999).

Here, the legislative history reveals that both the House and Senate Sponsors stated that one of the purposes of the act was to clarify what trust companies are subject to the banking act and the control of the Commissioner.[220]

> Senator Elsea: . . . Thank you, Mr. Chairman, members of the committee. Senate Bill 1603 is requested by the Department of Financial Institutions. And the law governing the regulation of the fiduciary activities of banks and trust companies in Tennessee is unclear and in need of updating and modernization. The present—presently, the law, the Tennessee banking act, provides that no trust company may be incorporated or be qualified to act as a fiduciary unless it is incorporated under the banking act or federal law.

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[218] *State v. Walls*, 62 S.W.3d 119, 121 (Tenn. 2001); *State v. McKnight*, 51 S.W.3d 559, 566 (Tenn. 2001).

[219] *Lavin v. Jordon*, 16 S.W.3d at 366 (citing *State v. Lewis*, 958 S.W.2d 736, 739 (Tenn. 1997)).

[220] TR, Vol. V, 656-658.

> However, there is no definition of what constitute [sic] a trust company and there is little guidance as to what fiduciary powers financial institution [sic] may engage in. ***And this bill will provide the guidance as to what constitutes authorized trust activity and what trust companies are subject to the banking act.*** ... (Emphasis added)[221]
>
> Rep. Woods: ...Senate Bill 1603 is an administration bill as it resulted from a study by the financial institutions over the summer and it was passed on the consent calendar and the Senate was, and removed from a consent calendar in the House for further explanation. And I'd like to give it at this time.
> Basically, the bill does five (5) things. It gives state chartered trust the authority — the same authority — as federal chartered trust have at this time. It allows them also to reach across state lines to establish a trust with a reciprocal agreement if one does exist with the other state. ***It clarifies what trust activities are. It brings them under the control of the Commissioner of Insurance and Banking here in the state*** and it eliminates the practice of — old practice— of shelf — of establishing shelf charters. Under which a business can come in and buy a banking charter that has been out of business for five (5) years. This changes that to two (2) years to keep it more current so that this practice wouldn't. ***It clarifies the powers and responsibilities of financial institutions and it defines what are fiduciary activities it can enter into.*** That's the explanation of that and I move that it be passed on third and final consideration. (Emphasis added)[222]

The legislative history further reveals that Public Chapter 112 was the result of a task force created by the Department of Financial Institutions in 1998 to consider new legislation to regulate trust companies.[223] This task force assisted the Department in drafting the proposed legislation, which was subsequently enacted as Public Chapter 112. Furthermore, in presenting the proposed legislation to both the Administration and the Legislative sponsors, the Department

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[221] *Id.*, 657-659.

[222] *Id.*, 656, 659.

[223] TR, Vol. VI, 728-729.

provided certain relevant information, including: (1) a section by section summary of the bill; (2) a report of anecdotal information; and (3) background information.[224]

The section by section summary states that Section 3 of the bill

> provides that the Banking Act shall apply to the regulation of trust companies, except to the extent that the Commissioner determines otherwise. ***This is a fundamental provision of this bill as it has not always been clear in the past what law governs the regulation and operation of trust companies.***[225] (Emphasis added).

The summary further states that Section 4 of the bill establishes how the Banking Act applies to trust companies currently subject to the Department's regulation and to grandfathered trust companies and specifically states that "[a]ll trust companies operating on July 1, 1999 shall have up to 3 years from July 1, 1999 to conform to the Banking Act."[226]

The anecdotal information report provided to the Administration and Legislative Sponsors first notes that with the passage of this proposed legislation, consumers "[w]ould be assured that trust companies offering fiduciary services in Tennessee will have some level of supervision." More importantly, this report goes on to note that the Department has identified three (3) pre-1980 trust companies that currently are not regulated by the Department pursuant to a grandfather clause and that the Department has informed these trust companies of what the proposed bill entails. Sentinel Trust Company was one of these three trust companies.[227] With respect to these three companies, the report specifically states:

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[224] *Id.*

[225] TR, Vol. VI, 730-733.

[226] *Id.*

[227] AR. Vol. I, 17, 206.

> Such companies, if determined to be acting as a fiduciary, will have 3 years from the effective date of this bill to conform to these new requirements. This will put all trust companies on a level playing field and will allow the Department to address citizen concerns on all trust companies regardless of when they were formed. Closing the pre-1980 loophole will also help prevent pre-1980 out of state trust companies from trying to claim that they should also not be subject to the Department's review should they seek to establish a presence in Tennessee.[228]

Further, the background information presented by the Department to the Administration and Legislative Sponsors specifically addresses these pre-1980 trust companies and the Department's concern that they were currently not regulated.

> From the Department's experience, it also was deemed important to clarify what fiduciary activities and companies should be subject to the Banking Act. That is particularly the case for a few trust companies that are not currently regulated due to an interpretation of the Department in the early 1980's. As these few companies are apparently otherwise indistinguishable from other regulated trust companies, there should be no reason that they should not be regulated. However, the Department recognizes that an appropriate timeframe must be given such companies to allow them to adjust to regulation and that has been provided for in the legislation.[229]

This information identifies the "subject matter [of Tenn. Code Ann. § 45-1-124], the object and reach of the statute, the wrong or evil which it seeks to remedy or prevent, and the purpose sought to be accomplished in its enactment" and conclusively establishes the Legislature's intent that ***all*** the provisions of the Banking Act apply to ***all*** trust companies in this state, pursuant to Tenn. Code Ann. § 45-1-124.

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[228] *Id.*

[229] *Id.*

Finally, in determining the meaning of a statute, the Tennessee Supreme Court has held that courts should give deference to the interpretation of the statute followed by the administrative agency charged with its enforcement or execution.[230] The Department of Financial Institutions is authorized to "execute all laws relative to persons doing or engaged in a banking or other business as provided in [title 45]."[231] The Department has clearly interpreted Tenn. Code Ann. § 45-2-124 to mean that all the provisions of Chapters 1 and 2 of the Banking Act apply to all trust companies in this state, as the Department itself drafted the proposed legislation. Moreover, the Department has consistently maintained this position as evidenced in the annual reports filed with the Governor pursuant to Tenn. Code Ann. § 45-1-119(a). The Banking Division section of the 1999 Annual Report states that "[a] major accomplishment for the [Banking] Division was the passage of Public Chapter 112 which amended the Banking Act, Tennessee Code Annotated Title 45, Chapters 1 and 2" and that among other things, this law "brings previously grandfathered trust companies under departmental jurisdiction, ..." The report goes on to state that no new trust companies were chartered in 1999, but "with the passage of Public Chapter 112, which amended the Banking Act, four previously grandfathered trust companies were brought under the Department's jurisdiction. The Division now supervises a total of 14 trust companies."[232] The Banking Division report also contains a consolidated balance sheet for all state-chartered trust companies and a consolidated income statement, as required by

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[230]*Consumer Advocate Division. Greer*, 967 S.W.2d 759 (Tenn. 1998); *Riggs v. Burson*, 941 S.W.2d 44 (Tenn. 1997).

[231]Tenn. Code Ann. § 45-1-104.

[232]TR, Vol. VI, 734-757.

Tenn. Code Ann. § 45-1-119(a)(3) and (5). Sentinel Trust Company is specifically listed on the consolidated income statement.[233]

The Department has continued to report this information concerning state-chartered trust companies in Tennessee, including any changes occurring with respect to trust companies by reason of opening new trust companies, mergers, and dissolutions (voluntary and involuntary) in its annual reports.[234] The Department has also continued to list Sentinel Trust Company on the consolidated income statements for state-chartered trust companies regulated by the Department.

Finally, appellants' argument that they are not subject to the provisions of the Bank Act, and in particular, Tenn. Code Ann. § 45-2-1502, because it only references "state banks" is contrary to their own actions. Specifically, in April of 2001, appellants submitted an application to the Commissioner, pursuant to Tenn. Code Ann. § 45-2-218, to amend the charter of Sentinel.[235] That statute speaks only in terms of a "state bank" and provides in pertinent part as follows:

> (a) A ***state bank*** shall apply to the commissioner to amend its charter or to change its location or the location of any of its branches. Any such change of location shall be consistent with the provisions of § 45-2-614.
> (b) An application for an amendment of the charter shall be authorized by the vote of at least a majority of the outstanding voting stock at a meeting of stockholders.
> * * *
> (e) Any amendment to the charter of an ***incorporated bank*** increasing or decreasing its capital stock or otherwise must be recorded in accordance with § 45-2-205(c). (Emphasis added).

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[233] *Id.*

[234] TR, Vol. VI, 758-802.

[235] TR, Vol. V, 510-530; AR, Vol. 1, 191-192.

Appellants' application to amend Sentinel's charter sought not only to change the principal office location, but to also delete the language "***but said corporation is not to carry on the business of banking***" from the charter, and to state the authorized amount of shares to be 5,000,000.[236] The Commissioner subsequently issued an amended and restated charter to reflect the changes and filed it in accordance with the requirements of Tenn. Code Ann. § 45-2-205(c).[237]

In summary, when it enacted the amendments to Tenn. Code Ann. § 45-1-124, the General Assembly intended to clarify that all state chartered trust companies are subject to ***all*** the provisions of the Banking Act. The Department of Financial Institutions has consistently interpreted that statute in a similar fashion. Finally, until the Commissioner took possession of Sentinel Trust Company, Appellants themselves acted consistently with this interpretation, *e.g.*, sought to amend their corporate charter, pursuant to the provisions of Tenn. Code Ann. § 45-2-218, which only speaks in terms of a state bank and paid without objection the Annual Assessment Fee authorized in Tenn. Code Ann. § 45-1-118(c)(2).[238] Accordingly, the trial court correctly found that the Commissioner acted with express statutory authority in taking possession of Sentinel pursuant to Tenn. Code Ann. § 45-1-1502.

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[236] *Id.* (Emphasis added).

[237] *Id.*

[238] TR, Vol. VI, 803-804.

III. There Is Substantial And/Or Material Evidence In The Record To Support The Commissioner's Decision To Take Possession Of Sentinel And Subsequent Decision To Liquidate.

As discussed *supra*, the scope of review under the common law writ of certiorari is limited to an inquiry into whether the Commissioner exceeded his jurisdiction, followed an unlawful procedure, acted illegally, fraudulently, or arbitrarily or acted without material evidence to support his decision to take possession of Sentinel and subsequent decision to liquidate the company. Appellants raise a number of arguments and/or issues in their brief which can best be summarized or characterized as an assertion that there is no substantial and material evidence in the record to support the Commissioner's decisions to take possession and to subsequently liquidate Sentinel.

1. Material Evidence In The Record Supporting Decision To Take Possession

Tenn. Code Ann. § 45-2-1502(a) provides that the Commissioner may take possession of a state bank or a trust company if he finds:

> (1) Its capital is impaired or it is otherwise in an unsound condition;
> (2) Its business is being conducted in an unlawful or unsound manner;
> (3) It is unable to continue normal operations; or
> (4) Its examination has been obstructed or impeded.

The Commissioner is only required to find that one of these conditions exists in order to take possession of a trust company. Thus, under the standard of review for the common law writ, if there is substantial or material evidence in the record to support a finding of any of these conditions, then the Commissioner's decision to take possession of Sentinel must be upheld.

The Commissioner took possession of Sentinel based upon the existence of two of these conditions: (1) that Sentinel's business was being conducted in an unsound manner and (2) Sentinel was unable to continue normal operations.[239] Specifically, the Commissioner found that Sentinel had used pooled fiduciary funds to provide operating capital for non-related defaulted bond issues, thereby creating a fiduciary cash shortfall that greatly exceeded Sentinel's current operating capital and that Sentinel had failed to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion and to keep accurate books and records.[240] The Commissioner further found that Sentinel's potential liability for the cash shortfall in the pooled fiduciary account exceeded its current capital level and that Sentinel has been unable to provide a viable capital plan that would eliminate the deficiency and make the account whole.[241]

Appellants have never denied any of these findings. Indeed, Appellants have admitted that: (1) the "customary mode of conducting [their] business has long been that all funds [Sentinel] receives as fiduciary under different bond issues are deposited in its correspondent F.D.I.C.-insured Bank account to be held in its name as a fiduciary, ..."[242]; (2) that "[m]oneys from what Respondent Commissioner has labeled the "pooled bond funds" were used in carrying out Sentinel's liquidation obligations, including the payment of attorneys fees, other litigation expenses, and in some cases, moneys required to be paid by orders of courts in some of the many

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[239]AR. Vol. III, 464-466.

[240]*Id.*

[241]*Id.*

[242]TR, Vol I, 1-22.

litigations occurring as a result of the defaults"[243]; and, (3) that this practice of borrowing from non-related bond issues monies on deposit in the pooled fiduciary account to fund the expenses of defaulted bond issues instead of using corporate assets, where the defaulted issues themselves did not have sufficient funds on deposit with Sentinel resulted in "a deficiency in cash in some unknown amount" in the pooled fiduciary account.[244] Moreover, Appellant Danny Bates, President of Sentinel, specifically testified that he used the "total cash held by the trust department" — the monies deposited in trust to be used for the purposes specified in the indenture — to pay the expenses of unrelated defaulted bond issues when they did not have any money, even though this was contrary to the indentures which governed Sentinel's actions as trustee.[245]

Thus, appellants admitted to engaging in a practice which is clearly in violation of Tenn. Code Ann. § 45-2-1003(1); the FDIC's Statement of Principles of Trust Department Management, adopted as part of Sentinel's corporate policies; and, the indentures or other contractual agreements between the bond issuers and Sentinel as fiduciary. Such a practice clearly constitutes the conduct of business in an unsound manner and thus, there is material evidence in the record to support the Commissioner's decision to take possession of Sentinel.

There is also material evidence in the record to support the Commissioner's decision to take emergency possession of Sentinel without a prior hearing pursuant to Tenn. Code Ann. § 45-2-1502(c)(1). That statute provides that "[i]f, in the opinion of the commissioner, an emergency

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[243] *Id.*

[244] *Id.*

[245] TE, Vol. XII, 175, Vol. XIII, 333-336, 343-344.

exists which will result in serious losses to the depositors, the commissioner may take possession of a state bank without a prior hearing. Any person aggrieved and directly affected by this action of the commissioner may have a review by certiorari as provided in title 27, chapter 9."

Appellants argues that the Commissioner had no authority under this statute to take possession of Sentinel without a prior hearing because Sentinel is not a bank and does not have any "depositors." While the term "depositor" is not defined in the Act, a "deposit" is defined as a "deposit of money, bonds, or other things of value, creating a debtor-creditor relationship."[246] Appellants attempt to characterize it as otherwise, however, it is undisputed in the record that significant amounts of cash were deposited by bond issuers into Sentinel's pooled fiduciary account. Indeed, in describing how Sentinel operated and maintained its books, President Danny Bates referred to the moneys received from bond issuers as "deposits" and that Sentinel "always kept up with who owned what money." In light of this testimony, appellants' argument that Tenn. Code Ann. § 45-2-1502(c)(1) is inapplicable because Sentinel does not have "depositors" is simply without merit.

Moreover, it was the trial court, and not appellants, that actually raised the issue of whether an emergency existed *factually* at the hearing on the petition for writ of certiorari. Previously ,Appellants had consistently taken the position that the Commissioner simply did not have any authority because Sentinel was neither a bank nor did it have depositors. In any event, the trial court correctly found that "when administrators deal with financial institutions there is little ground for half measures" and given that Sentinel's board had failed to act on the recommendations of their attorney or to respond to the Emergency Cease and Desist Order, as

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[246] *See* Tenn. Code Ann. § 45-1-103(9).

well as the fact that Sentinel was conducting business in an "unsound manner" and its capital was "impaired", the facts supported the conclusion of the Commissioner that an emergency existed and that the money in the pooled trust account belong to the bond holders was in immediate threat if he did not act.[247]

2. Material Evidence In The Record Supporting Decision To Liquidate.

On June 15, 2004, the Commissioner received a preliminary report from the Receiver and his staff which indicated that Sentinel had a fiduciary cash deficiency ranging from between $7.6 and $8.4 million (not including the additional $301,234.11 in outstanding bond principal and interest checks owed to bondholders).[248] The report further indicated that Sentinel was operating at a net loss and was insolvent at least in the amount of $6.225 million.[249] Based upon this information, the fact that management had no viable plan for the infusion of capital, and the record as a whole, the Commissioner determined that liquidation of the company was necessary and appropriate.[250]

While Title 45 provides specific grounds which must be met in order for the Commissioner to take possession of a bank or trust company, it does not provide any such statutory grounds or standards for determining when a bank or trust company in possession should be liquidated. Rather, it leaves the decision to the discretion of the Commissioner.[251]

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[247]TR, Vol. VII, 949-952.

[248]AR. Vol. III, 623-643.

[249]*Id.*

[250]R. Vol. III, 644-646.

[251]*See* Tenn. Code Ann. § 45-2-1502(b)(2) and (c)(2).

Thus, there is no statutory requirement that a bank or trust company be found to be insolvent in order for the Commissioner to liquidate that entity.

In this case, although they admit that "a deficiency in cash in some unknown amount" exists, Appellants still assert that the company was not insolvent and, therefore should not have been liquidated. They make a number of arguments in support of this position. First, they argue that the Commissioner's concerns over the shortfall in the pooled fiduciary account are based on a misunderstanding by the Commissioner regarding the intricacies of the trust business, the administration of bond issues and bond defaults and Sentinel's accounting methods. Second, they argue that the amount of the deficiency in the pooled fiduciary account is an "inflated" amount due to the accrual of Sentinel's administrative fees and one and half percent monthly interest charge and, therefore, does not represent an actual cash deficiency in that account. Third, since the funds in the pooled fiduciary account are not "due on demand", Appellants argue they are still able to meet their monthly bond payment obligations. Finally, Appellants assert there would have been no immediate risk in allowing them to "work out" the deficiency over time through Sentinel's administrative fees and expected recoveries on the remaining defaulted bond issues.[252] In making these arguments, Appellants rely primarily upon the testimony of Richard Whisenant. Mr. Whisenant testified that Sentinel was not insolvent based upon three factors: (1) it was continuing to make its bond payments; (2) it was continuing to pursue defaulters; and (3) it was making collections.[253]

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[252]TR, Vol I, 1-22.

[253]*See* fn. 150, *supra*.

With respect to Appellant's first argument that the Commissioner simply misunderstood everything from the trust business itself to the way Sentinel kept its accounting, the trial court rejected this position, based primarily upon two points: (1) Sentinel had experienced lawyers with knowledge of the trust business, none of whom ever expressed any doubt as to the Commissioner's understanding of Sentinel's condition in relation to the shortfall or use of the pooled trust account[254] and (2) neither Mr. Bates nor his lawyer ever told the Commissioner in writing or orally that he did not understand the trust business, the way it operated, its accounting standards, or that the Commissioner was mistaken and about to make a terrible mistake until several months after the Commissioner took possession and decided to liquidate.[255]

As to the remainder of Appellants' arguments, the credible evidence in the record is simply to the contrary. With respect to the "true amount" of the deficiency, the Receiver determined that Sentinel had a fiduciary cash deficiency ranging from between $7.6 and $8.4 million. This determination was based directly on the company's own records contained in the two different accounting systems — AccuTrust and Quickbooks.

In July of 2003, after his previous accountant left, President Bates was forced to hire an independent CPA to reconcile Sentinel's cash accounts, including the pooled fiduciary account.[256] In reconciling the pooled fiduciary account as of December 31, 2003, the independent

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[254]TR, Vol. VII, 950-951. In fact, the trial court found that the opinions and actions of Sentinel's lawyers was consistent with the Commissioner's view of Sentinel's financial condition. *Id.*

[255]*Id.* at 951. Again, the trial court found that Mr. Bates had implicitly agreed with the Commissioner's assessment of Sentinel's financial condition up through and including the Receiver's report in June, 2004.

[256]AR. Vol. I, 195-196.

CPA determined that the cash balance of that account was $10,897,183.[257] The AccuTrust system, however, showed a cash balance of $14,197,093 and Quickbooks showed a cash balance of $14,197,095 as of that same date.[258] Subsequently, at the time the Commissioner took possession of Sentinel on May 18, 2004, AccuTrust showed a cash balance in the fiduciary account of ***$10,280,912,*** while QuickBooks showed a balance of ***$10,386,921***. The bank statement from SunTrust, however, reflected a cash balance in the fiduciary account of only ***$2,472,928. Thus, based upon these amounts as reflected in Sentinel's records and the bank statement, there was a cash deficiency in the pooled fiduciary account of over $7.8 million.***

Furthermore, this determination of a substantial deficiency in the pooled fiduciary account was independently confirmed by David Lemke in his testimony. Mr. Lemke testified that the law firm had internally identified a shortfall in the amount of six to eight million dollars and that it was his understanding this shortfall was made up of real dollars, and not simply accounting figures.[259] He further testified that he was only able to identify approximately two and a half million that was attributable to expenses incurred on behalf of defaulted bond issues that had run out of cash, but whose assets had not yet been liquidated.[260] As for the remaining amount of the deficiency, Mr. Lemke testified that he received explanations from Danny Bates that simply made no sense.[261]

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[257]TR, Vol. IV, 449-456.

[258]*Id.*

[259]*Id.* at 53, 74.

[260]*Id.* at 55.

[261]TE, Vol. XII, 62-66, 78-80.

More importantly, as found by the trial court, Danny Bates himself confirmed that the pooled fiduciary account had a substantial cash deficiency. First, in a meeting on April 1, 2004, when questioned by Department examiners, Mr. Bates admitted that their analysis of the pooled fiduciary account and determination of a net cash shortage of $5,789,011 as of December 31, 2003 was correct.[262] Subsequently, on April 30, 2004, at a meeting between the Commissioner and Sentinel's board, Mr. Bates admitted that his most recent calculations showed that the net cash deficiency in the pooled fiduciary account had increased to approximately $7.25 million.[263] Significantly, at no time during that meeting did Mr. Bates indicate that a large portion of this deficiency was attributable to Sentinel's accrued fees and interest charges.[264]

Thus, approximately two weeks before the Commissioner took possession, Sentinel President Danny Bates admitted that the company had a fiduciary cash deficiency of $7.25 million. Given that Sentinel only had a net worth of $1.3 million,[265] that cash deficiency was, standing alone, sufficient evidence for the Commissioner to determine that liquidation was necessary and appropriate. However, there is other substantial and material evidence in the record that further supports the Commissioner's decision to liquidate.

While Danny Bates testified that Sentinel had annual revenues of as much as $1.3 million, Sentinel's own corporate tax returns reflected that its total net income for the past eight years was only $1,370,149.04, including the $575,000 settlement paid in 2000, which the

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[262]TR, Vo. IV, 451.

[263]*Id.* at 451-452.

[264]*Id.*

[265]Appellants have never taken issue with the Receiver's determination of the company's net worth.

company was required to recognize as a one-time charge to its income statement.[266] Without credit for this amount, Sentinel's total net income since 1996 would only be $795,149.04. Additionally Sentinel's current fee revenues were not sufficient to cover the operating expenses of the company. For the first four months of 2004, the company had a net loss of $163,501.16.[267] By the time the Commissioner took possession on May 18, 2004, that net loss had increased to $197,917.[268] Furthermore, in the examination report for the period ending December 31, 2001, the Department had noted that "[e]arnings are less than satisfactory and are not commensurate with the risk associated with the fiduciary activities undertaken. Risk exposure is noted in relation to the default issues and corresponding pending litigation which could threaten the company's capital base."[269] The report further noted that no reserves were maintained by management in relation to this risk.[270] Finally, the report noted that the company had no formal written strategic business plan, although the "directorate has periodic discussions of prospective business opportunities."[271]

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[266]TR, Vol. IV, 449-456.

[267]AR. Vol. III, 588.

[268]AR. Vol. III, 634. Included in this net loss position is the recognition of losses totaling $100,522 in relation to two defaulted bond issues: Sullivan County, TN and Jose Eber Salons, Inc. Management had previously used funds out of the pooled fiduciary account to fund expenses of both these defaulted issues and recorded those monies as overdrafts on these accounts. Management had now finally determined in April, 2004, that there would be no recovery on these two defaulted issues and, therefore, recognized the loss on its income statement. However, the recognition of the loss on the Jose Eber Salons issue was not recorded by management in the accounting of overdraft-receivable balances. Additionally, management only recognized a loss of $25,136 on the Jose Eber Salon issue, while its accounting records indicated that the overdraft-receivable balance was actually $133,701.96. *See* AR. Vol. III, 628. As such, management should have recognized an additional loss of $108,565.96 on its income statement, thus increasing the company's net loss to $306,482.96 as of May 18, 2004. TR, Vol. IV, 449-456.

[269]AR. Vol. I, 134.

[270]*Id.* at 133.

[271]*Id.*

In light of the admitted multi-million fiduciary cash deficiency well in excess of Sentinel's net worth; the company's past earnings performance; the lack of any reserve in relation to losses from defaulted issues; the lack of a strategic business plan; and current operations at a net loss, coupled with the fact that Appellants were unwilling to contribute more capital or to even submit an operational plan for how the company would eliminate the deficiency, the Commissioner's decision to liquidate was appropriate and clearly supported by substantial and material evidence in the record.

IV. Tenn. Code Ann. § 45-2-1502 Authorizing the Commissioner To Take Possession Of Sentinel Is Not Unconstitutional.

Appellants have raised a number of challenges to the constitutionality of Tenn. Code Ann. § 45-2-1502, which authorized the Commissioner to take possession of Sentinel Trust Company. First, Appellants assert that to the extent this statute authorizes the Commissioner to assume Sentinel's contractual obligations and rights to control all trust funds in its accounts by virtue of its status as Trustee and Paying Agent, it is in violation of the prohibition against the impairment of contractual obligations contained in Art. I, § 20 and Art. XI, § 16 of the Tennessee Constitution and Art. 1, § 10 of the United States Constitution. Next, Appellants argue that this statute violates Art. I, § 8 and Art. XI, § 16 of the Tennessee Constitution and the Fifth and Fourteenth Amendments to the United States Constitution in that it authorizes the Commissioner to seize the property of Sentinel and the property of bond-holders and bond issuers held in trust without just compensation. Finally, Appellants assert that Tenn. Code Ann. § 45-2-1502 violates the separation of powers provision of Art. II, § 2 of the Tennessee Constitution in that it allows

the Commissioner to place a trust company in receivership, which they assert is a judicial power vested solely in the Courts of Tennessee.

These arguments were all rejected by the trial court who found that the statute to be constitutional in all respects.[272]

1. Impairment of Contracts

Art. I, § 10, cl. 1 of the United States Constitution and Art. I, § 20 of the Tennessee Constitution provide as follows:

> § 10. Powers denied the states. - [1.] No state shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make any thing but gold and silver coin a tender in payment of debts; ***pass any bill of attainder, ex post facto law or law impairing the obligation of contracts***, or grant any title of nobility.[273]
>
> Sec. 20. No retrospective laws. - That no retrospective law, or law impairing the obligations of contracts shall be made.[274]

These constitutional provisions do not proscribe all retrospective laws, but rather proscribe only those laws that divest or impair vested substantive or contractual rights.[275] "Vested rights" are defined by the Tennessee Supreme Court as including those "which it is proper for the State to recognize and protect and of which the individual should not be deprived

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[272]TR, Vol. VI, 682-694.

[273]Art. 1, § 10, cl. 1 of the United States Constitution (emphasis added).

[274]Art. 1, § 20 of the Tennessee Constitution.

[275]*Hanover v. Ruch*, 809 S.W.2d 893, 896 (Tenn. 1991); *Miller v. Sohns*, 225 Tenn. 158, 162, 464 S.W.2d 824, 826 (Tenn. 1972); *Dark Tobacco Growers' Co-op Ass'n v. Dunn*, 150 Tenn. 614, 632, 266 S.W. 308, 312 (1924).

arbitrarily without injustice."[276] The Tennessee Supreme Court has further held that in order to be protected by Art. I, § 20, a "contract right" must be legally enforceable and must not conflict with the constitution, the statutes, or the common law.[277] Thus retrospective laws are those "which take away or impair vested rights acquired under existing laws or create a new obligation, impose a new duty, or attach a new disability in respect of transactions or considerations already passed."[278]

Initially, it should be noted that Appellants have failed to identify any vested or contractual rights other than to make the general assertion with respect to Sentinel's "contractual obligations and rights to control all trust funds in its bank accounts by virtue of its status as Trustee and Paying Agent."[279] Moreover, Tenn. Code Ann. § 45-2-1502 clearly does not constitute a retrospective law, as Sentinel had no vested or contractual rights at the time this statute was passed by the Legislature. Tenn. Code Ann. § 45-2-1502 was enacted by the Tennessee General Assembly in 1969 as part of the Tennessee Banking Act.[280] Sentinel's corporate charter authorizing it to act and engage in business as a trust company was not even issued until 1975.[281] Thus, at the time that Tennessee enacted the statute in question, Sentinel did

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[276]*Morris v. Gross*, 572 S.W.2d 902, 905 (Tenn. 1978).

[277]*Spiegel v. Thomas, Mann & Smith, P.C.*, 811 S.W.2d 528, 530 (Tenn. 1991). *See also, Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 648, 383 S.W.2d 1, 5 (1964) (recognizing that contracts that conflict with constitutions, statutes, or the common law violate public policy and are unenforceable).

[278]*Morris v. Gross*, 572 S.W.2d at 907.

[279]TR, Vol. I, 1-22.

[280]TR, Vol. V, 543-546.

[281]TR, Vol. I, 1-22.

not have — and could not have had — any vested or contractual right that was impaired because it did not even exist until seven (7) years after the enactment of this statute.

Furthermore, it is well settled that all laws in force when a contract is made, which affect its validity, construction, duration, discharge, evidence or enforcement, constitute a part of its obligation and are as much a part of it as if expressed in its stipulation.[282] Consequently, at the time that Sentinel entered into any contracts to act as Trustee and/or Paying Agent, the provisions of Tenn. Code Ann. § 45-2-1502 were in force and, therefore, were made as much a part of that agreement as if expressed therein.[283] Accordingly, Tenn. Code Ann. § 45-2-1502 does not unconstitutionally impair any vested substantive or contractual rights of Sentinel.

2. Taking Without Just Compensation

The Takings Clause of the Fifth Amendment provides that no "private property [shall] be taken for public use, without just compensation." Initially, it should be noted that Tenn. Code Ann. § 45-2-1504, which governs the liquidation of a trust company in the Commissioner's possession, provides in subsection (i) that "[a]ny assets remaining after all claims have been paid shall be distributed to the stockholders in accordance with their respective interests." In light of this provision, the Commissioner submits that there simply has been no "taking" of private property.

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[282] *Woodfin v. Hooper* 23 Tenn. (4 Humph.) 13 (1843); *Hannum v. McInturff*, 65 Tenn. (6 Baxt) 225 (1873); *Robbins v. Life Ins. Co.*, 169 Tenn. 507, 89 S.W.2d 340 (1936); and, *Cary v. Cary*, 675 S.W.2d 491, 493 (Tenn. Ct. App. 1984). *See also, Von Hoffman v. City of Quincy*, 4 Wall. 535, 550, 18 L.Ed. 403 (1868); *Walker v. Whitehead*, 83 U.S. 314, 21 L.Ed. 357 (1873); and, *Antoni v. Greenbow*, 107 U.S. 769, 27 L.Ed. 468 (1883).

[283] *See Security Pacific Equipment Leasing, Inc. v. FDIC*, App. No. E1999-00270-COA-R3-CV (2000 WL 145078), slip op. at 12 (Feb. 9, 2000).

Moreover, the United States Supreme Court has held that the "taking" of private property under the exercise of governmental authority other than the power of eminent domain does not violate the Takings Clause.

> The government may not be required to compensate an owner for property which it has already lawfully acquired under the exercise of governmental authority other than the power of eminent domain.[284]

Here, to the extent that the Commissioner has "acquired" any property, it was pursuant to the exercise of his authority in the Banking Act, and not pursuant to any powers of eminent domain. Furthermore, federal courts have specifically held that the appointment of a receiver for a savings and loan association was not a compensable taking under the Fifth Amendment, as neither the association nor its owner had a historically rooted expectation of compensation from such seizure, considering the regulated environment in which the association voluntarily operated.[285] Similarly, Appellants cannot have the necessary historically rooted expectation of compensation, in light of the regulated environment in which they have voluntarily operated. As such, there can be no claim of an unconstitutional taking.

3. Separation of Powers

The Tennessee Constitution states that "[t]he powers of the government shall be divided into three distinct departments: the Legislative, Executive and Judicial," and that "[n]o person or persons belong to one of these departments shall exercise any of the powers properly belonging

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[284] *Bennis v. Michigan*, 516 U.S. 442, 452, 116 S.Ct. 994, 1001, 134 L.Ed.2d 68 (1996)(citing *United States v. Fuller*, 409 U.S. 488, 492, 93 S.Ct. 801, 804, 35 L.Ed.2d 16 (1973); *United States v. Rands*, 389 U.S. 121, 125, 88 S.Ct. 265, 268, 19 L.Ed.2d 329 (1967)).

[285] *California Housing Securities, Inc. v. United States*, 959 F.2d 955 (Fed. Cir. 1992).

to either of the others, except in the cases herein directed or permitted."[286] The Tennessee Constitution does not define the powers of each department in express terms.[287] However, the Tennessee Supreme Court has restated a simplified description of each of these roles when it noted that "[t]he legislative branch has the authority to make, alter, and repeal the law; the executive branch administers and enforces the law; and the judicial branch has the authority to interpret and apply the law."[288]

While the departments of government have been characterized as "independent" and "co-equal,"[289] they have also been viewed as "interdependent" because their functions overlap.[290] Thus, while the doctrine of separation of the powers, as set out in and Article II, §§ 1 and 2, is a fundamental principle of American constitutional government, it has long been recognized that it is impossible to preserve perfectly the theoretical lines of demarcation between the executive, legislative and judicial branches of government.[291] As the Tennessee Supreme Court noted in *Richardson v. Young*:

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[286]Tennessee Constitution, Art. II, §§ 1 and 2.

[287]*See* Art. II, § 3, which vests all legislative authority in the General Assembly; Art. III, § 1, which vests the executive power in the Governor; and Art. VI, § 1, which vests the judicial power in the Supreme Court and the circuit, chancery and other courts established by the General Assembly.

[288]*Richardson v. Tennessee Bd. of Dentistry*, 913 S.W.2d 446, 453 (Tenn. 1995).

[289]*Mayhew v. Wilder*, 46 S.W.3d 760, 783 (Tenn.Ct.App.), *p.t.a. denied* (2001)(citing *Summers v. Thompson*, 764 S.W.2d 182, 189 (Tenn. 1988); *Moore v. Love*, 171 Tenn. 682, 686-87. 107 S.W.2d 982, 983-84 (1937)).

[290]*Id.* (citing *State v. King,* 973 S.W.2d 586, 588 (Tenn. 1998); *Underwood v. State*, 529 S.W.2d 45, 47 (Tenn. 1975)).

[291]*Bank of Commerce and Trust Company v. Senter,* 149 Tenn. 569, 260 S.W. 144, 151 (1924); *Richardson v. Young*, 122 Tenn. 471, 493, 125 S.W. 664 (1910).

> There are also some powers which, on account of the complexity of governmental functions, are difficult to classify, and may be, with equal propriety and correctness, committed to more than one department. . . .
> There are many acts possessing a legislative, executive or judicial character, especially peculiar to the very nature of our system, and necessarily inherent in it. Which time out of mind have not been exclusively exercised by these departments, and which, for the ease and efficiency of our system, could not be so exercised.[292]

Appellants assert that the power to impose a receivership is and has always been among the judicial powers vested in the Courts of Tennessee, and it is forbidden that any statute vest, or be construed as vesting any part of such judicial power in any member of the Legislative or Executive Departments of the State of Tennessee. As such, Appellants assert that the Commissioner's appointment of a receiver was in violation of the doctrine of separation of powers and was, therefore, void.

Contrary to these assertions, the power to institute a receivership is not the sole province of the courts. The power to institute a *court-created equity receivership* is one of the judicial powers vested in the courts. However, the power to institute an *administrative receivership* is clearly one that is vested in the executive branch of government. Indeed, the courts have recognized and upheld the distinction between an administrative receivership and a court-created equity receivership.[293] Here, the Commissioner's appointment of a receiver is part of a statutory scheme enacted by the General Assembly for the orderly liquidation of insolvent financial institutions, including trust companies.

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[292]122 Tenn. at 493-496, 125 S.W. 664.

[293]*See People ex rel. Knight v. O'Brien*, 240 N.E.2d 686 (Ill. 1968)(citing *In re Casualty Co. of America*, 155 N.E. 735 (NY 1927); *Riches v. Hadlock*, 15 P.2d 283, 288 (Utah 1932); *People ex rel. Barrett v. Shurtleff*, 187 N.E. 271 (1933); *People ex rel. Palmer v. Peoria Life Ins. Co.*, 192 N.E. 420 (1938)). *See also Hulman v. Lawn Savings and Loan Association*, 259 N.E.2d 324 (Ill. App. 1970).

As discussed *supra*, Tenn. Code Ann. § 45-2-1502(a) authorizes the Commissioner to take possession of a trust company if he finds that certain circumstances exist. Subsection (b)(2) provides that "[w]hen the commissioner has taken possession of a state bank, the commissioner shall be vested with the full and exclusive power of management and control, including the power . . . to appoint a receiver to have all of the rights, powers, duties and obligations granted to the commissioner in possession for the purpose of liquidation or reorganization, and to reorganize or liquidate the bank in accordance with §§ 45-2-1503 and 45-2-1504...."[294] Thus, the General Assembly has given the Commissioner the specific authority to appoint a receiver after taking possession of a trust company, and such appointment pursuant to this statutory scheme clearly creates an executive or administrative receivership, as distinguished from a court created equity receivership.[295] Furthermore, the United States Supreme Court has held that the administrative taking over of a financial institutions, *i.e.*, the appointment of a receiver, is constitutionally unobjectionable.[296]

Accordingly, the Commissioner's appointment of a receiver for Sentinel, pursuant to Tenn. Code Ann. § 45-2-1502, does not violate the doctrine of separation of powers.

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[294]Tenn. Code Ann. § 45-2-802(a) and (b) provides that the Federal Deposit Insurance Corporation (FDIC) may be appointed receiver of any state bank the Commissioner has taken possession of, whose deposits are to any extent insured by the FDIC and specifically gives the Commissioner, after taking possession of such state bank, the "right to appoint the Federal Deposit Insurance Corporation as receiver."

[295]*See People ex rel. Palmer v. Niehaus*, 190 N.E. 349 (1934). In that case the court held that receiverships established pursuant to the Illinois Insurance Liquidation Act of 1933 and the Illinois Banking Act were executive or administrative receiverships. The court further emphasized that "by the Insurance Liquidation Act and the Banking Act the legislature sought to 'avoid difficulties and complications attending the appointment of receivers by courts,' and that the statute 'makes the receiver an executive or administrative officer and not a judicial officer.'

[296]*Fahey v. Mallonee*, 332 U.S. 245, 67 S.Ct. 1552, 91 L.Ed. 2030 (1947).

CONCLUSION

For these reasons, Commissioner Lavender respectfully requests that this Court affirm the decision of the trial court denying the petition for writs of supersedeas and certiorari and dismissing the petition.

Respectfully submitted,

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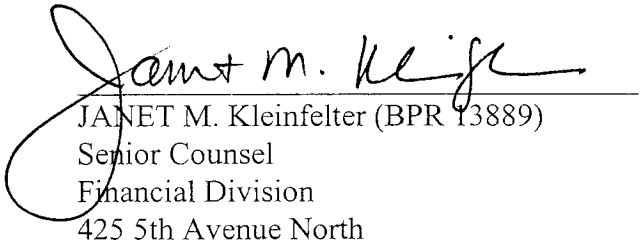

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing brief has been sent by first-class U.S. Mail, postage prepaid, to:

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this 14th day of October, 2005.

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